82-1806

Office-Supreme Court, U.S.
FILED
MAY 3 1983
ALEXANDER L. STEVAS
CLERK

No. _____

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1982

HAWAIIAN INDEPENDENT REFINERY, INC.,
Petitioner
vs.
THE UNITED STATES OF AMERICA,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

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QUESTIONS PRESENTED

1. Whether the Congressionally expressed goal of providing stimulus to a lagging economy by reestablishing the investment tax credit, should be frustrated by an unwarranted and restricted interpretation of the investment credit law transitional rule.

2. Where a refinery facility is designed, planned, built and inspected by independent contractors who control the details of the construction work, is the owner-taxpayer to be denied the investment credit under Internal Revenue Code § 50(a) which allows the credit if the property is "acquired by the taxpayer," but denies the credit if "construction of the property is completed by the taxpayer"?

PARTIES TO THE PROCEEDING

The parties to the proceeding in the United States Court of Claims and in the United States Court of Appeals for the Federal Circuit were Hawaiian Independent Refinery, Inc. and the United States of America.

STATEMENT OF CORPORATE AFFILIATION

Hawaiian Independent Refinery, Inc. is a wholly-owned subsidiary of Pacific Resources, Inc.; it has no subsidiaries. Pacific Resources, Inc. has no parent, and its subsidiaries and affiliates include Gasco, Inc., PRI Northwest, Inc., PRI International, Inc., Pacific Resources Terminals, Inc., Enerco, Inc., and PRI Solar, Inc.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

Hawaiian Independent Refinery, Inc. (HIRI) respectfully prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Federal Circuit, entered January 10, 1983.

OPINIONS BELOW

The opinion of the court of appeals (App. A) is reported at 697 F.2d 1063 (1983). The opinion of the trial judge in the court of claims (App. B) is not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on January 10, 1983. A petition for rehearing in banc was denied on February 23, 1983 (App. C). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). The jurisdiction of the court of claims was invoked by 28 U.S.C. § 1491; and the appeal was transferred to the United States Court of Appeals for the Federal Circuit pursuant to Public Law No. 97-164, Section 403(a), that court having jurisdiction under 28 U.S.C. § 1295.

STATUTORY PROVISIONS INVOLVED

The pertinent parts of sections of the Internal Revenue Code at issue in this case, and the pertinent regulations thereunder, are set out in full in the Appendix (App. D). The relevant sections, in summary, provide:

§ 38 allows as a credit against tax, the amount determined under subpart B. Subpart B includes the statutes summarized herein.

§ 46(a)(1) sets forth the rules to determine the amount of the credit.

§ 48(a) defined § 38 property to mean tangible personal property or other tangible property used as an integral part of manufacturing, production or extraction or of furnishing energy. § 48(b) defined new § 38 property to mean property (1) the construction of which is completed by the taxpayer after December 31, 1961, or (2) acquired after December 31, 1961. If construction is completed by the taxpayer after December 31, 1961, the credit determined under § 46 will apply only to that portion of the basis attributable to construction after that date.

§ 48(h) suspended the investment credit, effective

May 24, 1967. Section 49(a) terminated the credit for property for which construction was begun or which was acquired by the taxpayer after April 18, 1969.

§ 50(a) restored the investment credit by providing that § 49(a) (termination) shall not apply to property (1) the construction of which (A) is completed by the taxpayer after August 15, 1971, or (B) is begun by the taxpayer after March 31, 1971, or (2) which is acquired by the taxpayer (A) after August 15, 1971, or (B) after March 31, 1971 and before August 16, 1971, pursuant to an order placed after March 31, 1971.

§ 50(b) provided a transitional rule for property described in subsection (a)(1)(A), the construction of which began before April 1, 1971, by limiting the credit to that portion of the basis attributable to construction after August 15, 1971.

STATEMENT OF THE CASE

In 1962, Congress enacted the first investment credit law to encourage modernization and expansion of the nation's production facilities by immediately reducing income taxes, thus increasing capital funds available for investment. The credit was suspended in 1966 (Internal Revenue Code, § 48(h)) and terminated in 1969 (Internal Revenue Code, § 49(a)). In 1971, Congress reenacted the investment credit law by § 50 of the Internal Revenue Code. § 50 is substantially identical to § 48(a) of the 1962 Act, except for subsections (a)(1)(B) and (a)(2)(B), which expanded coverage.

HIRI was incorporated in 1968 to establish a new refinery facility in Hawaii. It had few employees. There were only a handful of engineers, and some secretaries, until 1972.

HIRI did not possess the expertise, manpower or ability to design and build the refinery facility. A refinery plant, offshore

mooring and pipeline, and product pipeline were proposed. HIRI entered into design and construction contracts with one engineering-construction company, two engineering companies and two construction companies to design, construct and inspect all construction. All engineers and contractors were independent, free of supervision from HIRI.

HIRI informed the engineers of the product slate to be produced, the expected sources of crude oil and the general location of the facilities. It played no other material role in the construction process, except (a) to make some recommendations to reduce the scope of basic plans when first cost estimates were too high, and (b) to supervise the startup of the plant in 1972.

Planning for the plant began in 1970. Foster-Wheeler Corporation, a New Jersey based engineering contractor, prepared the basic design. Site clearing and preparation began in early 1971. Major items of equipment were ordered around June 1971. Real construction began one month later.

The engineering and construction for the offshore mooring and product pipeline took place after March 1971.

The trial judge's recommended findings and conclusions to the United States Court of Claims were to the effect that HIRI "constructed" and did not "acquire" the refinery. He concluded that HIRI was not entitled to the investment credit for materials ordered and construction activities prior to August 15, 1971. (App. B) The trial judge acknowledged that there was no real factual dispute. His findings were carefully structured to omit every objective fact demonstrating HIRI's nonparticipation in the construction process. The undisputed, omitted facts showed that HIRI exercised no control over the details of the work.

While HIRI's exceptions to the findings and conclusions of the trial judge were pending, the structure of the court of claims

changed. It combined with the court of customs and patent appeals and became the United States Court of Appeals for the Federal Circuit. By order of the new United States Claims Court, entered October 8, 1982, the recommendations of the trial judge were converted to a judgment.

The court of appeals affirmed (App. A) the "judgment" of the trial judge. In so doing, it ignored or repudiated several prior rulings of the court of claims, the court in which the case was filed. The effect was to hold that construction of the refinery plant, the offshore mooring and the product pipeline were "completed *by the taxpayer*" under Internal Revenue Code, § 50(a)(1)(A), although HIRI did not:

a. prepare the basic plan or designs;

b. prepare any working drawings;

c. construct the facilities itself or supervise or direct any construction; or

d. inspect the construction work, except after hours and on weekends when no construction activities were taking place.

The court of appeals held that the facilities, costing about $32,000,000, were "constructed by" HIRI with only one supervisory employee, two engineers and a small office staff.

To avoid the apparent absurdity of determining that the refinery was constructed, rather than acquired, by HIRI under such circumstances, the trial judge and the court of appeals engaged in some strange mental gymnastics.

a. They not only rejected the ruling of another court of appeals in *Public Service Company of New Mexico v. United States*, 431 F.2d 980 (10th Cir. 1970), they disregarded the essential principles established by their predecessor court in *Lykes Bros. Steamship Co., Inc. v. United States*, 206 Ct.Cl. 354, 513 F.2d 1342 (1975) and *Pacific Far East Lines, Inc. v. United States*, 206 Ct.Cl. 378, 513 F.2d 1355 (1975). Those cases held that general or limited control over specifications is

not enough to deny the credit; *the test is who controls the details of the construction work*. The most important factors are who prepares the working drawings, and who performs the actual construction and inspection. All of these were prepared and performed by independent contractors and not by HIRI; HIRI did not even provide any supervision.

b. They repudiated a 7-year dedication to liberal construction of the investment credit. See, for example, *Alabama Displays, Inc. v. United States*, 205 Ct.Cl. 716, 507 F.2d 844, 848 (1974); *Lykes Bros. Steamship Co., Inc. v. United States*, 206 Ct.Cl. 354, 513 F.2d 1342, 1353 (1975); *Pacific Far East Line, Inc. v. United States*, 211 Ct.Cl. 71, 544 F.2d 478, 484 (1976); *Panhandle Eastern Pipeline Co. v. United States*, ____ Ct.Cl. ____ , 654 F.2d 35 (1981):

> In *Lykes Bros.*, the court found that the taxpayer's investment qualified for the credit under the transition rules. In so holding, the court relied heavily on the fact that "remedial legislation should be construed liberally to effectuate its purpose" and "interpreted liberally in keeping with its purposes." (p. 44)

The only reason cited by the court of appeals for the change (opinion, page 18, note 13; 697 F.2d at p. 1069) was a comment in a Congressional committee report (S. Rep. No. 437, 92d Cong., 1st Sess. 8-9 (1971); 1971-2 CB 563) on a part of Internal Revenue Code, § 50, not in question in this case. The report referred to § 50(a)(2)(B) which extended coverage for a special situation. The court of appeals omitted the introductory words, "In addition," to the language it quoted. It overlooked the immediately preceding paragraph of the committee report which explained that the renewed credit was "along the lines of the investment credit repealed in 1969." The report did not indicate any change in the well established principles of liberal construction.

c. The court of appeals applied (App. A, pages 4-5) Internal Revenue Regulation § 1.48-2(b), clause 1, to the effect that property is considered constructed by a taxpayer if work is done for him in accordance with his specifications. That paragraph, questioned extensively in *Lykes, supra*, pp. 1349-50, was not adopted in the regulations under the 1971 Act. Regulation, § 1.50-1(c) provided only that the former regulations would be applied in determining "when property is acquired" and "that portion of the basis attributable to construction after August 15, 1971." Nothing is mentioned about considering property to be constructed by the taxpayer. Reference to the former regulation as a basis for denying HIRI part of the credit was unsound.

REASONS FOR GRANTING THE PETITION

a. The decision of the court of appeals is directly in conflict with the decision of the Court of Appeals for the Tenth Circuit in *Public Service Company of New Mexico v. United States*, 431 F.2d 980 (1970):

> . . . Only if it had authoritative control with respect to the manner and means in which and by which the details of the work were to be performed would the Company be limited to a credit on the basis of construction costs after December 31, 1961. (p. 983)

The decision here is irreconcilable with prior decisions of the court of claims in *Lykes Bros. Steamship Co., Inc. v. United States, supra:*

> . . . General or limited control over the contract plans and specifications is, in and of itself, insufficient to establish the degree of control necessary to find that the property was constructed "by the taxpayer." (p. 1350)

and *Pacific Far East Lines, Inc. v. United States, supra.*

b. The question presented is important in the administra-

tion of federal tax laws. Settlement of the question in this court is in the public interest. Several similar cases are now pending in the United States district and tax courts and before the Internal Revenue Service. Among them are: *Big Three Industries, Inc. v. United States*, Civil Action No. H-82-755 (S. D. Texas); *Illinois Power Company v. United States*, Docket No. 14701-79 (U. S. Tax Court); *Puget Sound Power and Light Company v. United States*, Docket No. 23121-81 (U. S. Tax Court); and *Menominee Paper Company of Menominee, Michigan v. United States*, Docket No. 11792-78 (U. S. Tax Court).

The question is one of statutory interpretation. The plain meanings of "constructed by" and "acquired by" were distorted by the Internal Revenue Service and now by one court of appeals. The meanings, where the work is performed by independent contractors, receive different treatment depending upon the forum available or chosen. The differences should be resolved by this Court.

c. The scope of the determination in this case goes beyond the statutes involved and the situation of the present taxpayer. As Congress changes government policy, conferring and withdrawing tax benefits to guide the direction of the national economy, transitional rules are usually prescribed to govern the effects of the changes. Congress often specifies that only situations arising after the effective date of the statute are to be affected. In adopting investment credit statutes in 1962 and 1971, Congress emphasized that economic stimulation through tax reduction was a paramount goal. The trial judge and the court of appeals ignored the instructions of Congress and frustrated the Congressional purpose.

The transitional rule of § 50 followed the tested language of § 48(b) which defined new section 38 property in terms of "construction of which is completed by the taxpayer" and

"acquired." § 50(a) used the same language, with the insert "by the taxpayer" after "acquired" in subparagraph (2). The transitional paragraphs at the end of § 48 and in § 50(b) are virtually identical, except for the new language to expand coverage for the period April 1 to August 15, 1971.

Nothing in the statutory language or the committee reports justifies the surprisingly restrictive interpretation of the court of appeals in this case. The tenth circuit court decision in *Public Service Company of New Mexico* was on record when § 50 was adopted. The court of claims confirmed the liberal interpretation principles on the transitional rule in the *Lykes* case, *supra* (p. 1353) and *PFEL*, *supra*. The dedication to those principles continued unabated through eight (or more) decisions until the *HIRI* case.

The Commissioner deemed the question sufficiently important to issue Rev. Rul. 80-312, CB 1980-2, 6, concluding that the Internal Revenue Service will not follow *Public Service Co. of New Mexico v. United States*, 431 F.2d 980 (10th Cir. 1970). Compare that repudiation of the independent contractor test with Rev. Rul. 82-134, IRB 1982-28, July 12, 1982, recognizing that a general contractor is responsible for the final product, including "control over every element of the contract, not only as to results but also as to the details and means by which the result is achieved." Both rulings were published after the complaint was filed in this case.

The trial judge's change in interpretative standards was unwarranted; the explanation was faulty. The affirmance by the court of appeals resulted in a conflict between circuits in interpretation of transitional rules on the investment credit. Two courts of appeals expressed different approaches to interpretation of the transitional rules. The divergent results prevent uniform application of the applicable principles by taxpayers and the Commissioner. Review by this Court is warranted.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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May 2, 1983

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

HAWAIIAN INDEPENDENT REFINERY, INC., Appellant, v. THE UNITED STATES, Appellee.	)	Appeal No. 240-79 T

DECIDED: January 10, 1983

Arthur B. Reinwald argued for appellant. With him on the brief were *Ronald I. Heller* and *Hoddick, Reinwald, O'Connor & Marrack.*

Gilbert W. Rubloff argued for appellee. With him on the brief were Assistant Attorney General *Glenn L. Archer, Jr., Theodore D. Peyser,* and *Robert S. Watkins.*

Before FRIEDMAN, RICH, BENNETT, MILLER, and SMITH, *Circuit Judges.*

MILLER, *Circuit Judge.*

This appeal is from a judgment of the United States Claims Court[1] in favor of the Government in a suit for refund of 1974 corporate income taxes of $572,772 and interest of $142,782.83 paid on an Internal Revenue Service assessment based on disallowance of a portion of the investment tax credit claimed on the 1974 return of Hawaiian Independent Refinery, Inc., ("HIRI") with respect to an oil refinery complex consisting of (1) the refinery, located thirteen-

[1] Entered October 8, 1982, pursuant to this court's order of October 4, 1982, and corresponding to the decision recommended by the trial judge in his opinion filed February 1, 1982.

miles from Honolulu in the Campbell Industrial Park, (2) an offshore tanker-mooring facility connected to the refinery by pipelines, and (3) pipelines for transport of refined petroleum products to HIRI's storage facilities in the Honolulu area.[2] We affirm.

The Investment Tax Credit

The investment tax credit was initially provided by the Revenue Act of 1962 (Pub. L. No. 87-834, 76 Stat. 962), which added section 38 to the Internal Revenue Code of 1954 (''IRC'') allowing a tax credit for ''qualified investment'' in certain depreciable property, known as ''new section 38 property'' and limited[3] to property—

(1) The construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1961, or

(2) acquired after December 31, 1961, if the original use of such property commences with the taxpayer and commences after such date.

In the Tax Reform Act of 1969 (Pub. L. No. 91-172, 83 Stat. 487, 660), section 703(a), Congress terminated the investment tax credit, excluding from the term ''section 38 property'' that property whose physical construction began after April 18, 1969. However, in section 101(a) of the Revenue Act of 1971 (Pub. L. No. 92-178, 85 Stat.

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[2]Total overpaid taxes were claimed in the amount of $963,749, but only $572,772 was available for 1974 because of limitations on use of investment tax credit carryovers in any one year; the remainder of $390,977 would have resulted from carryovers to later years. The total of $963,749 represents a credit of seven percent of $13,767,844, the cost basis of the refinery complex properly attributable to construction on or before August 15, 1971, which construction the Government contends was not eligible for said credit. The parties stipulated to the following cost bases attributable to construction on or before August 15, 1971:

Marine Terminal	$ 1,906,956
Products Pipeline	538,251
Refinery	11,322,637
	$13,767,844

The cost bases upon which HIRI claimed an investment tax credit were:

Marine Terminal	$ 6,570,752
Products Pipeline	2,084,201
Refinery	23,145,634
	$31,800,587

[3]In section 48(b), IRC.

498), Congress restored the investment tax credit by adding section 50, IRC, which provides:

§ 50. RESTORATION OF CREDIT

(a) General rule

Section 49(a) (relating to termination of credit) shall not apply to property—

(1) the construction, reconstruction, or erection of which—

(A) is completed by the taxpayer after August 15, 1971, or

(B) is begun by the taxpayer after March 31, 1971, or

(2) which is acquired by the taxpayer—

(A) after August 15, 1971, or

(B) after March 31, 1971, and before August 16, 1971, pursuant to an order which the taxpayer establishes was placed after March 31, 1971.

(b) Transitional rule

In applying section 46(c)(1)(A) [defining "qualified investment"] in the case of property described in subsection (a)(1)(A) the construction, reconstruction, or erection of which is begun before April 1, 1971, there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection after August 15, 1971 . . .

Treasury Regulation § 1.50-1(c) provides that the "principles of [Regulation] § 1.48-2(b) and (c) shall be applied in determining when property is *acquired* and in determining that portion of the basis of property properly attributable to construction, reconstruction, or erection after August 15, 1971." (Emphasis added.) Regulation § 1.48-2(b) provides, *inter alia*—

(1) Property is considered as constructed, reconstructed, or erected by the taxpayer if the work is done for him in accordance with his specifications.

. . . .

(5) Construction, reconstruction, or erection by the taxpayer begins when physical work is started . . . .

(6) Property shall be deemed to be acquired when reduced to physical possession, or control.

In passing, we note the rationale for restoration of the investment tax credit in 1971 which is set forth in S. Rep. No. 437, 92d Cong.,

1st Sess. 8 (1971):

> H.R. 10947 provides substantial tax reductions to individuals and substantial tax incentives to business in order to bolster the economy.

The committee report also states that—

> the credit is extended to property ordered on and after April 1, 1971, to avoid discrimination against those who took action on or after that date to acquire eligible assets on the basis of assurances as to the availability of the credit made by the Secretary of the Treasury, after consultation with the ranking members of the Congressional taxwriting committees. The assurance was given to avoid further deferment of investments which were already at an unduly low level.

Id. at 8-9. *See also* H.R. Rep. No. 533, 92d Cong., 1st Sess. 5 (1971).

CONTENTIONS OF THE PARTIES

HIRI argues that it *acquired* the refinery after August 15, 1971, under a turn-key contract[4] and that the entire cost of the refinery complex qualified for the investment tax credit. The Government maintains that the trial judge correctly held that the refinery complex was *constructed* (not acquired) "by the taxpaper" for purposes of section 50(a)(1)(A), IRC, and, therefore, as related above, that the cost basis of $13,767,844 attributable to construction on or before August 15, 1971 (*see supra* note 2), was not eligible for the investment tax credit.

BACKGROUND

The Honolulu Gas Co., Ltd., which manufactured gas from fuel oil for distribution as a public utility, became interested during the 1960's in expanding and diversifying its energy business by engaging

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[4] A turn-key job is defined as "a job or contract in which the contractor agrees to complete the work of building and installation to the point of readiness for operation or occupancy." *Webster's Third New International Dictionary* (1971 ed.). Up to that point, the contractor assumes all risks. *Mobile Housing Environments v. Barton and Barton*, 432 F. Supp. 1343, 1346 (D. Colo. 1977); *Glassman Const. Co. v. Maryland City Plaza, Inc.*, 371 F. Supp. 1154, 1157 (D. Md. 1974), *aff'd mem.*, 530 F.2d 968 (4th Cir. 1975).

in the refining and sale of other petroleum products. In early 1968, James Gary, president of the company, and Paul Joy, its vice president for engineering, met with John Evans, an independent petroleum industry consultant, to undertake the initial planning and organization of such a project. Representatives of Foster Wheeler Corporation (''Foster Wheeler''), a large engineering consulting firm experienced in oil refinery construction, were brought into the discussions and planning.

As conceived, the refinery complex was to be a unitary facility consisting of three major components: a straight-run refinery; an offshore tanker-mooring facility located about two miles from the refinery, with an underwater/underground pipeline system connecting to the refinery; and two refined petroleum products pipelines to transport jet fuels and multi-purpose distillate produced by the refinery to various storage facilities in the Honolulu area. The refinery was to be built in an area to be designated a foreign trade zone in order to avoid federal customs duties on the crude oil imports and state taxes on the refined products. It was to have an initial refining capacity of less than 30,000 barrels per day in order to qualify for a ''small business'' set-aside in Government procurement.

In 1968, Honolulu Gas Co. separately incorporated HIRI to develop and operate the facility. HIRI selected the Campbell Industrial Park as the site for the refinery and obtained a 55-year lease of the property. The Federal Government granted an application by the Governor of Hawaii on the foreign trade zone matter, and HIRI obtained a foreign crude oil import allocation from the Secretary of the Interior. It also applied for the permits and licenses required for the proposed construction.

Also in 1968, HIRI selected Foster Wheeler for its consultant in preparing preliminary studies on the engineering and economics of the refinery. Foster Wheeler also assisted HIRI in preparing plans and technical studies used to support the foreign trade zone application. Because HIRI did not have the personnel needed, it retained three engineering firms to serve as design engineers and construction supervisors: Foster Wheeler for the refinery; Bechtel, Inc., for the tanker-mooring facility; and an affiliate of Williams Brothers Engineering Co. for the products pipelines. As prime contractors for construction, HIRI retained Foster Wheeler for the refinery, Healy Tibit Construction Co. for the tanker-mooring facility, and Hood Construction Co. for the products pipelines. HIRI also arranged for a

foundation study, soil tests, and clearing and grading the refinery site.

HIRI hired as its vice president and general manager Earl Beebe, a retired oil refinery operator with forty-eight years' experience in refinery construction and operation, to oversee the design and construction of the entire facility, and, particularly, to see to it that the refinery being designed by Foster Wheeler would be efficient and would conform to HIRI's purposes. He, in turn, hired Edward Quance, another experienced refinery operator, manager, process-designer, trouble shooter, and start-up engineer, as project engineer for the refinery, and Bruce Bean, a mechanical engineer who had previously worked on planning of the facility, as project engineer for the two offsite components. Mr. Quance's duties included assisting Mr. Beebe by doing the engineering work needed to be sure that the Foster Wheeler designs and specifications were satisfactory and by auditing and inspecting Foster Wheeler's work product. However, due to the vast amount of documentation produced by Foster Wheeler's engineers and draftsmen, they could only check the drawings and specifications they deemed important and spot check others. From the latter part of 1970 until the refinery was placed in service in June 1972, HIRI's staff consisted of Messrs. Beebe, Quance, and Bean, a couple of marketing men, and some secretaries.

ANALYSIS

Lykes and Pacific Far East Line

Of greatest precedential effect[5] on this court in this case are two Court of Claims cases: *Lykes Bros. Steamship Co. v. United States*, 513 F.2d 1342 (1975), and its companion case, *Pacific Far East Line, Inc. v. United States*, 513 F.2d 1355 (1975), in both of which it was decided that the taxpayer was entitled to the investment tax credit computed on its entire cost basis because, as held by the court, the vessels involved were *acquired* by the taxpayer after December 31, 1961, for purposes of section 38, IRC, added by the Revenue Act of 1962. As in this case, the Government contended that the involved property (vessels) was *constructed* by the taxpayer, much of it being done prior to the effective date of the investment tax credit. In

[5] *See* this court's opinion in *South Corporation v. United States*, 690 F.2d 1368, 215 USPQ 657 (Fed. Cir. 1982).

explaining its disagreement with the Government's position, the Court of Claims in *Lykes*, 513 F.2d at 1351, said that "the right of control is the most important factor to be considered in determining whether the work is done for the taxpayer 'in accordance with his specifications.'"[6] On the facts of each case, the court concluded that the taxpayer did not exercise sufficient control over construction. It observed that the Government (through the Federal Maritime Board) had an "overwhelming degree of control" over the contract at all stages from the beginning of construction to delivery of the vessels and that Maritime had the right to control the design specifications in every detail. It noted that, at all material times during construction, the contractor (shipbuilder) maintained physical possession and control over the vessels, the work being done at its shipyards, and that the vessels were not turned over to the taxpayer until they had satisfactorily met Maritime tests and sea trials during which they were manned by the contractor's crews. In finding that the taxpayer's role in the construction of the vessels was "primarily a passive one," the court, in *Pacific Far East Line*, 513 F.2d at 1360, commented that "the contract assigned no role to the taxpayer apart from removal of the vessels from the shipyards after completion and formal delivery."

Right of Control

With respect to the factor of right of control, HIRI relies on the statement of the Court of Claims in *Lykes*, 513 F.2d at 1348, that the phrase "constructed . . . by the taxpayer" requires "control over the details of the construction" and argues that such control was absent here because appellant did not prepare any working drawings and did not exercise any supervision over the workmen who built the refinery and the two offsite components. HIRI also asserts that it had a

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[6] In *Public Service Co. of New Mexico v. United States*, 431 F.2d 980, 983 (10th Cir. 1970), strongly relied upon by appellant, which involved construction of a 66,000 kilowatt electric generating plant, the court remarked: "Right of control is the touchstone in this suit." It rejected the idea that "control and supervision which every owner has the right to exercise over the general work" meets this test. It also said, in dictum, that the purpose of the phrase "in accordance with his specifications" in the regulation was "to distinguish between work done by independent contractors and mere employees." However, the Court of Claims in *Lykes*, 513 F.2d at 1351, made clear that it did not wish to go that far and, indeed, HIRI states that "it does not consider mere construction by an independent contractor, without more, to be conclusive that property was acquired by the taxpayer."

"turnkey contract" with Foster Wheeler to build a plant that worked as guaranteed, bringing it within the scope of *Public Service Co. of New Mexico v. United States, supra* note 6, in which the contractor followed the taxpayer's specifications on results desired, but independently designed, engineered, constructed, tested, and turned over to the taxpayer a complete operational, electric generating plant.[7] However, we are persuaded that HIRI takes too narrow a view of "control over the details of the construction"; also, that its agreement with Foster Wheeler was *not* a turn-key contract.

Regarding the latter, the contract with Foster Wheeler provided that, upon mechanical completion of the work but prior to mechanical acceptance by HIRI, Foster Wheeler would give written notice to HIRI, which would have ten days to give notice of any items requiring additional work,[8] and, upon completion, correction, or repair of such items, HIRI would give Foster Wheeler a letter of mechanical acceptance; thereafter, HIRI would exclusively handle the start-up of the facility, and Foster Wheeler would complete all painting, thermal-insulation, and final clean-up; after notice that construction was complete, HIRI would give Foster Wheeler a certificate stating that the work was completed and accepted; finally, the contract provided that "*HIRI shall at all times bear the risk of damage to, or loss of, . . .* all materials, equipment, tools, supplies and other items furnished by Foster Wheeler or by others for the Work, except construction tools and equipment owned or used by Foster Wheeler and . . . *all work completed or in progress, resulting from any cause whatsoever.*" (Emphasis added.) It is to be noted that the latter provision distinguishes this contract from a turn-key contract under which it is the *contractor* who assumes all risks up to the point of readiness for operation; further, that in *New Mexico*, it was the

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[7] Indeed, the Tenth Circuit said: "There does not appear in the record any direct testimony that Public Service [the taxpayer] . . . did anything more than specify the technical data and performance expectations sought from the completed installation," and it observed that while Public Service did have an employee on the job site nearly every day, "the job of this man was only that of an inspector who in fact acted much like a liaison man between the contracting parties"; further, that the contractor's construction superintendent "had complete control over the entire project." (431 F.2d at 983-84.) Such a passive role played by the taxpayer in that case and in *Lykes* and *Pacific Far East Line* is a far cry from the active control exercised by HIRI in this case, as developed *infra*.

[8] HIRI furnished a list of approximately 50 items requiring repair before acceptance.

contractor—not the taxpayer—which handled the start-up, following which a "complete operational unit" was turned over to the taxpayer.

Regarding "control over the details of the construction," the contract provided that the Work was to be in accordance with nine exhibits and an appendix of five volumes of technical specifications, which were used by Foster Wheeler as a basis for preparing construction and shop drawings; that

> HIRI shall have the right, at any time and from time to time prior to mechanical acceptance of the Work, to request in writing alterations in, additions to and deletions from the Work, which are hereinafter referred to as "Changes." Promptly upon each such request, Foster Wheeler shall prepare and submit to HIRI a detailed estimate of the net effect of a requested Change on the cost of the Work, on the Mechanical Acceptance date, and on the warranties and guarantees . . . After Foster Wheeler and HIRI reach agreement with respect to the estimate, Lump Sum Price shall be adjusted accordingly and Foster Wheeler *shall* proceed with the Change. If agreement with respect to the estimate is not reached, HIRI shall have the right to *require* Foster Wheeler to make the Change . . . . [Emphasis added.]

The contract further provided that HIRI could specify materials or services from suppliers, vendors or subcontractors, other than those selected by Foster Wheeler and that the price of the Work would be adjusted accordingly; that Foster Wheeler would procure all materials and services "as agent of HIRI"; that HIRI would be responsible, at such time as required by Foster Wheeler, for services in Foster Wheeler's office of an engineer authorized by HIRI to approve designs and drawings, and for all permits, licenses, and similar documents required to be in HIRI's name in connection with the Work and operation of the Plant. During construction, it should be noted, Messrs. Beebe and Quance visited the refinery worksite several times per week, focusing their inspection on workmanship, but also checking some of the equipment and apparatus to verify that it was being installed and erected in accordance with the contract plans and specifications. Also, the parties communicated with each other on an almost daily basis by mail, telex, or telephone, and as of January 1972 Foster Wheeler had sent to HIRI some 475 letters of telexes and HIRI had sent Foster Wheeler 305. The trial judge found that it was "not feasible to trace and identify all of those portions of

the final designs, drawings, plans and specifications that were attributable to HIRI's ideas, proposals, suggestions, recommendations, or instructions," but concluded that "to a significant extent HIRI's employees influenced and affected the content and makeup of the contract plans and specifications," and that "the facility . . . actually constructed was superior to and at a lower cost than that which would have been built had HIRI provided no input."[9]

We are satisfied that the record sufficiently supports the trial judge's conclusion that, for purposes of section 50(b), IRC, and regulation 1.50-1(c), the refinery was constructed, and not acquired, by HIRI.[10] Moreover, his conclusion is consistent with the clear understanding of Congress that, for purposes of both the investment tax credit and the analogous accelerated depreciation deduction, construction of the property need not be done by the taxpayer's own employees, but can be pursuant to a contract with an independent contractor. H.R. Rep. No. 2087, 89th Cong., 2d Sess. 31 (1966); S. Rep. No. 1724, 89th Cong., 2d Sess. 3, 16-17, 23-25 (1966); H.R. Rep. No. 413, 91st Cong., 1st Sess. 183-84 (1969); S. Rep. No. 552, 91st Cong., 1st Sess., 229-30 (1969).

Two Offsite Components Part of a Single Property

An alternative argument made by HIRI is that the full cost of the two offsite components (tanker-mooring facility and refined products pipelines), considered separately from the refinery, qualified (whether acquired or constructed by HIRI) for the investment tax credit because construction work *on them* did not begin until May 21, 1971, and November 30, 1971, respectively, after the effective date of restoration of the investment tax credit, April 1, 1971. This approach would leave only the refinery (physical construction on it began, after the site leased by HIRI had been cleared, in January of

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[9] Prior to execution of the contract, Foster Wheeler submitted to HIRI for its approval a design for the refinery together with an estimate of cost. HIRI rejected the estimate, which was higher than the amount budgeted, and Quance was directed to work with Foster Wheeler to devise a "reduction-in-scope program" to effect a cost savings of five to ten percent. The result was modification of five to ten percent (in dollar value) of the Foster Wheeler design.

[10] We are also satisfied that the record sufficiently supports the trial judge's conclusion that the two offsite components of the refinery complex were constructed, and not acquired, by HIRI.

1971) subject to the limitation on the investment tax credit required by the Transitional Rule of section 50(b), IRC.[11]

The trial judge, noting that nothing in the statutes or regulations deals specifically with what is a single property for purposes of section 50, IRC, reasoned that the tanker-mooring facility is used to transport raw materials to the refinery and the products pipelines connect the refinery with HIRI's storage facilities, so that the two offsite components, "in conjunction with the refinery itself, functionally form a single property," construction of which began when construction was begun on the refinery component. We regard this as a reasonable approach, particularly since the refinery complex was conceived, designed, and constructed as a unit, the three components being placed in operation concurrently.[12] Thus, the investment tax credit is only allowable to HIRI with respect to that portion of the basis that is attributable to construction after August 15, 1971.

In view of all the foregoing, the judgment of the United States Claims Court is *affirmed*.[13]

AFFIRMED

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[11] *See supra* note 2, which shows the impact of the Transitional Rule when the two offsite components and the refinery are treated as a single property.

[12] The Government argues that if the tanker-mooring facility and the refined products pipelines are considered separate projects, and, thus, "separate properties" for purposes of section 50, they would not qualify as "section 38 property" under section 48(a)(1)(B), IRC. However, we need not address the merits of this argument in view of our disposition of this case.

[13] HIRI argues that the trial judge's interpretation of the applicable law is improperly restrictive contrary to the Court of Claims' "dedication to liberal construction of the investment credit law." HIRI's position appears to be that, even though the incentive to business that motivated Congress to restore the investment tax credit was not a factor in construction of the refinery complex, a "liberal" approach compels this court, in construing the Transitional Rule of Section 50, IRC, to ignore the clear intent of Congress not to allow tax credits on construction prior to the effective date of the law. We believe the Congressional intent is highly relevant and note, particularly, the statement in S. Rep. No. 437, 92d Cong., 1st Sess. 8 (1971), quoted earlier in this opinion, that "the credit is extended to property ordered *on and after* April 1, 1971." (Emphasis added.)

APPENDIX B

IN THE UNITED STATES COURT OF CLAIMS

TRIAL DIVISION
No. 240-79T
(Filed: February 1, 1982)

HAWAIIAN INDEPENDENT REFINERY, INC.	)	Federal income taxes; Investment Tax Credit; whether property constructed or acquired by taxpayer for purposes of I.R.C. § 50(b); whether property may be divided into its major components for investment credit effective date purposes.
v.	)	
THE UNITED STATES	)	

Arthur B. Reinwald, attorney of record, for plaintiff. *Ronald I. Heller, Hoddick, Reinwald, O'Connor & Marrack*, of counsel.

Gilbert W. Rubloff, with whom was *Acting Assistant Attorney General John F. Murray*, for defendant. *Theodore D. Peyser and Robert S. Watkins*, of counsel.

OPINION*

MILLER, *Trial Judge:* This is a suit for refund of corporate income taxes paid by plaintiff for the year 1974. The principal question at issue is whether plaintiff's oil refinery facility was constructed by the taxpayer during a period overlapping the effective date for the investment tax credit reinstituted by the Revenue Act of 1971 (Pub. L. No. 92-178, 85 Stat. 497) or acquired by it after such date. If it was constructed by the taxpayer, a subsidiary question is whether or not two of the three major components thereof may be deemed

*The trial judge's recommended decision and conclusion of law are submitted in accordance with Rule 134(h).

separable properties with dates for beginning construction later than that of the project as a whole.

Despite almost 600 pages of testimony and abundant exhibits, the pertinent evidentiary facts are not substantially in dispute. The question is the legal effect to be given to the sum total of the facts which follow.

I.

The Honolulu Gas Company, Ltd. ("Honolulu Gas"), which manufactured gas from fuel oil for distribution as a public utility company in that city, became interested during the 1960's in expanding and diversifying its energy business by engaging in the refining and sale of other petroleum products. John K. Evans, an independent petroleum industry consultant, also saw a need for an additional petroleum refinery in Honolulu, close to the market it would serve. In early 1968 Evans met with James Gary, president of Honolulu Gas, and Paul Joy, its vice-president for engineering, and they involved themselves in the initial planning and organization of such a project. Evans brought into the discussions and planning representatives of Foster Wheeler Corporation ("Foster Wheeler"), a large engineering consulting firm experienced in oil refinery construction.

The refinery was to be built in an area to be designated by law as a foreign trade zone, so as to enable the avoidance of federal customs duties on the crude oil imports and state taxes on the refined products so long as the products remained in bond or were sold to outgoing vessels. The refinery was to sell to the military establishment in Hawaii a substantial part of the jet fuel, diesel fuel, gasoline, and fuel oil which the latter might otherwise purchase abroad. The plant was to have an initial refining capacity of less than 30,000 barrels per day so as to qualify for a "small business" set-aside in government procurement with attendant bidding advantages.

As originally conceived, the facility included three major components: a grass-roots, straight-run oil refinery (the "refinery"); a marine terminal consisting of an offshore tanker-mooring facility located about 2 miles from the refinery, with an underwater/underground pipeline system extending from the mooring to the refinery (the "marine terminal"); and two refined petroleum products pipelines to transport jet fuels and multi-purpose distillate produced by the refinery to various storage areas in the Honolulu area

(the "products pipelines"). The facility's design allowed for the receipt of crude oil from large tankers moored in deep water, the pumping of the oil directly to refinery storage tanks without further loading and unloading, the distillation of the crude oil into finished products, and the transmission of the products to storage tanks conveniently located near customers, of which the most important was the Pearl Harbor naval base 13 miles away from the refinery site.

In 1968 Honolulu Gas separately incorporated the Hawaiian Independent Refinery, Inc. ("HIRI") to develop and operate such a facility. HIRI chose the Campbell Industrial Park at Barber's Point, located 13 miles from Honolulu, as the site for the refinery. In 1968 HIRI obtained a commitment for a 55-year lease of this property. During the same year it prepared an application to be filed with the Federal Government by the governor of Hawaii for the establishment of a subzone in the foreign trade zone at Barber's Point, which the Federal Government granted. Thereafter it obtained a foreign crude oil import allocation from the Secretary of the Interior, and it applied for the necessary permits and licenses needed for the proposed construction.

From the time of its incorporation in 1968 until shortly before the refinery became operational in 1972, HIRI's entire business and all of its affairs were devoted to the planning, construction and financing of the facility.

In 1968 HIRI selected Foster Wheeler to be its consultant in the formulation of preliminary studies on the engineering and economics of the refinery. Foster Wheeler assisted plaintiff in the preparation of the plans and technical studies which were used to support the foreign trade zone application. These related to the economic feasibility of the project, the yields to be obtained from the various types of crude oil and the engineering and petroleum technology which would be involved.

From the start, HIRI had to make many decisions affecting the specifications for the facility, such as: the types of crude oil which would be imported and processed in the refinery; how the crude oil was to be received; the daily refining capacity to be achieved; the types of products to be produced and marketed; and how the finished products were to be delivered to both military and civilian customers.

Since HIRI did not have the personnel to do the designing and process engineering, it retained three engineering firms to serve as design engineers and construction supervisors: Foster Wheeler for the

refinery; Bechtel, Inc. (''Bechtel'') for the marine terminal; and an affiliate of Williams Brothers Engineering Co. (''Williams Bros.'') for the products pipelines. HIRI's agreement with Foster Wheeler contemplated that the latter would also be the prime contractor for the actual construction of the refinery. Additionally, plaintiff contracted with the Healy Tibbits Construction Co. (''Healy Tibbits'') for construction of the marine terminal, and with Hood Corporation (''Hood'') for construction of the products pipelines. Plaintiff retained Dames & Moore to conduct a foundation study and soil tests, and hired E. E. Block, Ltd. to clear and grade the site.

From the outset, HIRI's officials were concerned that, if left to their own devices, Foster Wheeler's engineers might not design an oil refinery geared to HIRI's specifications and that they might ''gold plate'' or overdesign the refinery at excessive cost in order to assure themselves that the facility would produce the desired products and quantities in accordance with Foster Wheeler's performance guarantees.

To alleviate such concerns, while the project was still in the planning stage and before any construction commenced, HIRI hired as its vice-president and general manager Earl Beebe, a retired oil refinery operator with 48 years of experience in refinery construction and operation. Mr. Beebe's responsibility was to oversee the design and construction of the entire facility, and specifically to ensure that the refinery being designed by Foster Wheeler would be operable efficiently by HIRI and conform to HIRI's planned purposes. In turn, in September 1970, Mr. Beebe hired Edward Quance, another experienced refinery operator, manager, process-designer, trouble shooter, and startup engineer, to serve as project engineer for the refinery, and Bruce Bean, a mechanical engineer employed by Honolulu Gas, who had previously worked on the planning of the facility, to serve as project engineer for the two off-site components. Mr. Quance's duties included assisting Mr. Beebe by doing the engineering work necessary to check out the Foster Wheeler designs and specifications, and by continually auditing and inspecting Foster Wheeler's work product. Additionally, he was required to review in detail those Foster Wheeler designs, plans and specifications he thought important and to suggest alternatives to Foster Wheeler in order to achieve the results HIRI wanted. It was also anticipated that Mr. Quance would do some general design and engineering work himself.

Prior to the actual commencement of construction, HIRI specified to Foster Wheeler its objectives, the planned method of operation, the kind of crude oil it expected to obtain, the kinds of finished products it desired to produce, the site, the nature of the soil to be encountered in building the foundation, the maximum funds which plaintiff had available for the construction within the limits of which Foster Wheeler had to plan, and related information. Foster Wheeler engineers in turn prepared preliminary engineering flow diagrams and process and project engineering plans for plaintiff's approval, and, thereafter, vast numbers of plans, drawings and designs which it routinely made available to Messrs. Beebe and Quance for plaintiff's approval and comments.

During the design formulation period, Messrs. Beebe and Quance devoted much of their time to reviewing and commenting on Foster Wheeler drawings and specifications. However, due to the vast amount of documentation produced by Foster Wheeler, Messrs. Beebe and Quance only checked those drawings and specifications they deemed important and merely spot-checked others.

The contracting parties communicated with each other on an almost daily basis, either by mail, telex or telephone. Neither plaintiff nor Foster Wheeler has preserved the full record of their communications, but Foster Wheeler numbered sequentially the written communications it sent and received, and these indicate that as of January 1972 (3 to 4 months before mechanical completion of the refinery) it had sent to plaintiff 475 letters and telexes and had received from plaintiff 375.

During the design formulation period Mr. Beebe made at least 10 trips from Hawaii to Foster Wheeler's New Jersey office where he spent a minimum of 45 full days working. Mr. Quance is not certain as to the total time he spent in Foster Wheeler's office, but from October through December 1970 he made at least one trip a month there. During these visits Messrs. Beebe and Quance customarily approved designs and drawings, and reviewed such items as schedules, progress reports, specifications, models, purchase orders, and vendors lists.

Mr. Quance occasionally furnished sketches to Foster Wheeler to illustrate how he thought the refinery should be designed. He was especially instrumental in changing Foster Wheeler's proposed plot plan to make the refinery more compact in order to save piping and construction funds, and was also actively involved in designing the

piping system for the refinery.

Foster Wheeler generally followed HIRI's recommendations and suggestions as long as HIRI agreed to pay for any substantial additional costs resulting from them and they did not prevent Foster Wheeler from meeting its construction schedule and process guarantees.

In September of 1970, shortly after Mr. Quance began working for plaintiff, HIRI authorized Foster Wheeler to place orders in plaintiff's name for the refinery tanks and fractionating columns, major items of equipment for the proposed refinery, costing approximately $5 million.

Although physical construction of the refinery (after the site had been cleared) began in January 1971, HIRI and Foster Wheeler did not execute a firm contract until June 1971. Instead, during this period the parties proceeded on the basis of an understanding that Foster Wheeler would be compensated on a cost-reimbursable basis until such time as it could arrive at a definitive estimate of cost which was within the limits of the financing available to HIRI and acceptable to it. Foster Wheeler continued to act as purchasing agent for plaintiff, placing orders in HIRI's name for all major items of equipment and supplies and for subcontracting services. Indeed, for the first two or three months of this period, Foster Wheeler paid for materials out of a checking account maintained by HIRI for such purpose. HIRI not only had to approve all such purchases and subcontracts but also had the right to approve all vendors. Mr. Beebe devoted a substantial portion of his working time to checking orders for supplies and equipment.

Until June 1971, neither side had any assurance that the parties would be able to reach agreement on a maximum or fixed price for construction of the refinery. In early 1971 Foster Wheeler submitted to HIRI, for its approval, a design for the refinery together with a definitive estimate of cost. While HIRI accepted most of the engineering data, it rejected the estimate, which was considerably higher than it had budgeted for the refinery. Projected cost overruns on the other two offsite components further aggravated the situation.

Plaintiff thereupon instructed Mr. Quance to devise ways in which to reduce the cost of Foster Wheeler's proposed project by approximately 5 to 10 percent, *i.e.*, by one to two million dollars. As part of the reduction in scope Quance effected, *inter alia*, the redesign of the sour water stripper; the relocation of the flare stack; the

elimination of a number of valves, pumps and a caustic wash system; the standardization of the tank farm pumps, reductions in the length of piping and in the size of steam generators and pumps; the redesign and rearrangement of the Merox (desulfurization) units; and the removal of construction of the refinery building from the scope of Foster Wheeler's work. As a result of Quance's discussions with Foster Wheeler, the latter too came up with ways of saving money, the principal one being the elimination of a structure for the crude overhead exchanger.

The modifications were ultimately reduced to writing and incorporated in the Foster Wheeler contract proposal as an "Addendum to Scope of Work" dated June 17, 1971, consisting of 23 scope changes. These effected the desired 5 to 10 percent reduction in dollar value of the Foster Wheeler design.

It is not feasible to trace and identify those portions of the final designs, drawings, plans and specifications attributable to HIRI's ideas, proposals, suggestions, recommendations or instructions. It is clear, however, from the record that to a significant extent the HIRI employees influenced and affected the content and makeup of the contract plans and specifications, and that the refinery that was actually constructed was superior to and lower in cost than that which would have been built had HIRI provided no input.

On an unspecified date in June 1971, HIRI and Foster Wheeler executed a definitive contract stated to be effective as of May 12, 1970, in the fixed sum of $21,324,000, payable by a series of scheduled progress payments. Foster Wheeler agreed to perform process engineering; prepare all drawings, specifications and requisitions; procure all materials and subcontract services as agent of HIRI (except when procured in the field); inspect, expedite, and arrange for shipment and delivery of all materials to the work site; furnish supervision, labor and construction tools and equipment; and construct and erect the refinery, tank-truck loading station and parking area—all in accordance with nine exhibits and five volumes of technical specifications.

Under the contract, at any time prior to mechanical acceptance of the work HIRI had the right to specify purchase of materials or services from vendors or subcontractors other than those selected from a jointly approved vendors list and to order alterations, additions to and deletions from the work, subject to price adjustments for changes in cost.

The contract provided that HIRI was responsible for providing at its own expense a work site cleared of vegetation and obstruction, graded and fenced; all reference points established and set in place; services of an engineer authorized by HIRI to approve designs and drawings; all building permits, licenses and similar documents; information as to the type and design of foundation to be used, including, in the case of pile foundations, advice as to the type and length of pile and the design bearing load per pile, and, in the case of spread foundations, safe loading values and depth for encountering such values; parking space for construction workers' cars; proper electricity and water; all tools, record sheets, log tables, laboratory and testing facilities, and other consummable supplies for maintenance, operation and acceptance testing of the plant; and all labor, materials, mobile and maintenance equipment for start-up, maintenance and operation of the plant.

It further provided that all materials were to become HIRI's property f.o.b. vendors' plant; and that HIRI at all times was to bear the risk of damage to or loss of materials, tools, supplies, and other items, whether furnished by Foster Wheeler or by others, from the time they were placed in transit, and of all work completed or in progress, resulting from any cause whatsoever. HIRI was also to provide all risk insurance covering all such items and property insurance on all materials and supplies intended for incorporation into the work until delivered to the work site.

Finally, HIRI retained the right at any time to suspend the work for 30 days, subject to payment of Foster Wheeler's expenses resulting therefrom, and to terminate the work entirely subject to the obligation to reimburse Foster Wheeler for its costs plus 2½ percent thereof. In the event of such termination, Foster Wheeler was to vest in HIRI all its rights under agreements with vendors and others and to deliver to HIRI all drawings, data, and other materials prepared by Foster Wheeler.

As permitted by the contract, Foster Wheeler subcontracted almost all of the construction work, with the bulk thereof to 15 subcontractors. Most of the work involved the assembly and installation of equipment. However, Foster Wheeler acted as the construction supervisor for the refinery. It sent a crew of 10 to 15 supervisors to coordinate, inspect and supervise the construction, and they were at the work site continuously. They dealt with the subcontractor's supervisors, who in turn gave orders to the workmen on the job site.

Foster Wheeler also prepared working or construction drawings to carry out the contract specifications, which the workmen used.

But during the construction period Messrs. Beebe and Quance also were not idle. They checked the construction drawings, often offering comments, suggestions and recommendations regarding them. They visited the work site several times per week, generally after regular working hours. They checked the equipment and apparatus to verify that it was being installed and erected in accordance with the contract specifications, and they inspected the workmanship carefully. Pursuant to the "changes" clause in the contract, the parties made 15 modifications to the contract plans and specifications, mostly at HIRI's request, plus an unspecified number of lesser modifications not involving cost adjustments, also at HIRI's behest.

As part of the reduction-in-scope, HIRI had decided to arrange for the construction of the refinery administration building itself. Mr. Quance prepared a basic sketch of the floor plan and HIRI let the construction work out to a contractor. After completion of the building in early 1972, several months before finishing of the refinery, some of HIRI's personnel moved into the building and thereafter were present at the worksite on a full-time basis.

Foster Wheeler gave HIRI notice of mechanical completion of the refinery in April 1972. The first crude oil arrived during that month and the refinery became operational two months later. HIRI handled the start-up of the refinery itself, and made its own decision as to the manner of conducting the start-up after a disagreement with Foster Wheeler on the subject. It also presented to Foster Wheeler a punch list of approximately 50 defects which required repair before it would accept the work. As a result the facility was not totally completed until 1973.

In regard to the marine terminal, HIRI's original arrangement with Bechtel was that HIRI would outline generally its planned method of operation and Bechtel would design what it deemed suitable to carry it out. But since at the time of the agreement HIRI had not decided finally how many pipelines it needed, the size of the ships it wanted to accommodate at the mooring point, the length of the underwater pipeline, the number of terminals, whether or not it would also convey finished products to outgoing barges for transportation elsewhere, and other alternatives, it had Bechtel draw up many designs. Though Bechtel made design proposals, HIRI exercised

final authority over design decisions, including the ultimate decision to use a multipoint, rather than a single point, mooring system.

HIRI's agreement with Bechtel provided that HIRI should have full access to and the right to inspect any part of the project at any time, including all drawings, plans, cost estimates, schedules and other documents prepared for the project. HIRI's primary representative for the review of Bechtel's proposed plans and specifications was Mr. Bean, its project engineer. His principal responsibility was to verify the plan's workability. In addition, HIRI retained an outside consultant to assist it in the selection of the best type of moorings and mooring equipment for the ships and also to review Bechtel's plans and designs.

Bechtel's initial plan for the marine terminal contemplated a single pipeline running from the offshore mooring site to the refinery. However, after HIRI's personnel became concerned that the pour point of the kind of crude oil HIRI contemplated procuring was at too high a temperature to allow the oil to flow readily through the cooler water and that the pipeline would clog, they devised a more sophisticated four-line pipe system which would enable heating and cleaning of the conduit.

HIRI entered into two service contracts with Bechtel. The first called for Bechtel to procure materials on HIRI's behalf and to perform engineering services for the design of the marine terminal. It also provided that Bechtel would assist HIRI in advertising for and evaluating bids for the construction contract and recommend to HIRI the selection of a construction contractor.

The second agreement between HIRI and Bechtel stated that "subject to the general direction and control of HIRI," Bechtel would perform a range of services comprised of planning, scheduling, estimating and cost control; procurement; construction management; commissioning, start-up and initial operation; and administration. It stated that in the performance of these services Bechtel was to be "the authorized representative or agent of HIRI," and it called for Bechtel to "consult with HIRI in advance of important decisions and commitments relating to the Project."

HIRI selected Healy Tibbits to serve as the construction contractor for the marine terminal, and they executed a formal agreement as of May 21, 1971. The contract provided that Healy Tibbits was responsible for executing the work in accordance with the specifications without deviation, and that "[a]ll detailed drawings prepared

by the Contractor shall be submitted for owner's approval before orders for materials are placed."

The contracts contemplated that HIRI would furnish most of the materials needed for the construction and that HIRI would retain title thereto at all times. HIRI purchased the major items of material, including the pipe, before it let the construction contract for the marine terminal. The first crude oil flowed from the mooring terminal through the pipeline and into the refinery in April 1972.

HIRI also established the design criteria for the products pipelines, determined their routes, capacities and terminals, and made provision in the overall plan for eventual establishment of the system. HIRI also obtained the many easements and rights of way needed for the pipeline routing.

In connection with the products pipelines, HIRI entered into a contract with Williams Brothers, having an effective date of May 1, 1971, which provided that the latter would act as HIRI's "agent and manager of construction to perform, or cause to be performed, the engineering, design and material procurement; to manage and inspect the construction to completion * * * and to act generally for [HIRI] and in all matters duly assigned in connection therewith." As in connection with the other components of the facility, HIRI retained final authority to approve the design of the products pipelines.

By agreement dated November 30, 1971, HIRI contracted with Hood for construction of the products pipelines. This agreement likewise contemplated that HIRI would furnish most of the materials and would retain title thereto. It also purchased the pipe and other major items of materials before this contract was let.

II.

Section 38 of the Internal Revenue Code of 1954 ("the Code" or "I.R.C.") (26 U.S.C.)[1] allows a credit against the income tax otherwise imposed, for investment in certain depreciable property. Section 46(a)(1) provides that the amount of such credit is 7 per cent of the "qualified investment." Section 46(c)(1) defines "qualified investment" with respect to any taxable year as including "the applicable percentage [based on length of useful life] of the basis of each new section 38 property * * * placed in service by the taxpayer

[1] All Code section references are to the Internal Revenue Code of 1954.

during such taxable year." Section 48(a) defines "section 38 property" to include depreciable tangible personal property, or other tangible property used as an integral part of, or as a storage facility in connection with manufacturing or the furnishing of transportation.

In 1969 Congress terminated the credit by amending the Code to add Section 49, which, *inter alia*, excludes from the term "section 38 property" property "the physical construction of which was begun after April 18, 1969 * * * ."[2] In 1971, however, Congress reinstated the investment tax credit. It added new Section 50 to the Code[3] providing:

SEC. 50. RESTORATION OF CREDIT.

(a) *General Rule.*—Section 49(a) (relating to termination of credit) shall not apply to property—

(1) The construction, reconstruction, or erection of which—

(A) is completed by the taxpayer after August 15, 1971, or

(B) is begun by the taxpayer after March 31, 1971, or

(2) which is acquired by the taxpayer—

(A) after August 15, 1971, or

(B) after March 31, 1971, and before August 16, 1971, pursuant to an order which the taxpayer establishes was placed after March 31, 1971.

For property which was in the process of being constructed prior to April 1, 1971, but was completed after August 15 of that year, the same section provided a rule allowing credit only for the costs attributable to construction after August 15, 1971, to wit:

(b) *Transitional Rule.*—In applying section 46(c)(1)(A) in the case of property described in subsection (a)(1)(A) the construction, reconstruction, or erection of which is begun before April 1, 1971, there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection after August 15, 1971. * * *

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[2] Section 703(a), Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487.

[3] As added by Section 101(a) of the Revenue Act of 1971, Pub. L. No. 91-172, 83 Stat. 660.

Treasury Regulations § 1.48-2(b)[4] contains a series of rules designed to assist in determining whether and when property is "acquired" or "constructed" by a taxpayer. It provides in part:

§ 1.48-2 *New Section 38 property.*

* * * * *

(b) *Special rules for determining date of acquisition, original use, and basis attributable to construction, reconstruction, or erection.* * * *

(1) Property is considered as constructed, reconstructed, or erected by the taxpayer if the work is done for him in accordance with his specifications.

* * * * *

(5) Construction, reconstruction, or erection by the taxpayer begins when physical work is started on such construction, reconstruction, or erection.

(6) Property shall be deemed to be acquired when reduced to physical possession or control.

Plaintiff claims that under the authority of Code Section 50(a)(2)(A) and Treasury Regulations Section 1.48-2(b)(6) it is entitled to use its entire cost of the Hawaiian Independent Refinery facility in calculating its investment credit, because it "acquired" the facility sometime after April 8, 1972, when it received the notice of mechanical completion from Foster Wheeler. Plaintiff contends that it did not "construct" the facility within the meaning of Section 50(a)(1) because it had insufficient control over the details of construction. It maintains that the transitional rule of Section 50(b) is thus inapplicable and that, therefore, it may include pre-August 15, 1971

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[4] Although Regulation § 1.48-2 was promulgated in 1964 (T.D. 6731 (1964-1 C.B. 11)) to interpret Section 48(b) of the Code, which provides for the initial phasing in of the investment credit in 1962, Treasury Regulation § 1.50-1(c) (T.D. 7203 (1972-2 C.B. 12)) promulgated under Section 50(b) provides:

> (c) *Principles to be applied.* The principles of § 1.48-2(b) and (c) shall be applied in determining when property is acquired and in determining that portion of the basis of property properly attributable to construction, reconstruction, or erection after August 15, 1971.

This regulation makes direct reference to the title of the § 1.48-2(b) regulation, and, taken in conjunction with the legislative history of § 48 of the Code, indicates that all the rules of § 1.48-2(b), including § 1.48-2(b)(1), which is the focus here, are applicable to the instant case. *See* H. Rep. No. 1447, 87th Cong., 2d Sess. A21 (1962), 1962-3 C.B. 519.

costs in measuring its allowable investment tax credit. Defendant's position is that the facility was "constructed" by plaintiff within the meaning of Section 50(a)(1) because the facility was built for plaintiff in accordance with its specifications within the meaning of Treas. Reg. § 1.48-2(b)(1). The facility having been constructed by plaintiff, defendant argues, the transitional rule of Section 50(b) applies and consequently plaintiff is entitled only to investment tax credit with respect to its costs for the property incurred after August 15, 1971.

Plaintiff's primary argument is the literal one: It cannot be subject to the limitation for property the construction of which "is completed by the taxpayer after August 15, 1971," if the property was completed by an independent contractor. However, a major difficulty with this argument is that even if it were correct, plaintiff would not necessarily be entitled to the full investment credit it claims, because it also has to establish affirmatively that the facility was "acquired by the taxpayer" after August 15.[5] If construction of a plant or facility on the taxpayer's premises through contractors is literally not construction by the taxpayer, it is also literally not an acquisition of the plant or facility from the contractors, particularly where the taxpayer supplies the major items of material and equipment and the ultimate specifications.

Moreover, contrary to plaintiff's argument, common usage does not confine the phrase "constructed by" to what a person constructs with his own hands or those of his own employees. That phrase, or its synonym, "built by," is also frequently used to describe the operations of a company or person which provides the financing and causes a building, plant or other facility to be built for it on its own land by a building contractor. Real estate developers are commonly referred to as builders of particular projects even when they and their employees have no actual construction skills.

The record in this very case reflects similar usage by plaintiff's own witnesses. Earl Beebe, plaintiff's vice-president and general manager, testifying as to his experience in refinery construction, stated that when he had been manager of refining for Champlin

[5] It is apparent that in the context of Section 50, Congress and the Treasury have understood the terms "acquired" and "constructed" to be mutually exclusive, with the former term being in the nature of a one-shot event, as in the case of a purchase, and the latter being in the nature of a series of acts.

Petroleum Company for 15 years, "we built" a good many refineries. In using this phrase, he explained, he meant to describe an operation very similar to that in the instant case. Champlin financed the construction but hired Fluor Corporation, a large engineering firm similar to Foster Wheeler, to act as general contractor. In response to a question as to who made the final decision that a multi-point mooring should be used in the marine terminal, Bruce Bean, plaintiff's engineer for the offsite components of the project, stated that Beebe had told him "we decided to build a multi-point mooring." Lowell E. Mee, vice-president and treasurer of HIRI, testified that the reason that Foster Wheeler purchased materials and equipment as agent for HIRI was that Foster Wheeler had told them that HIRI could avoid Hawaiian excise taxes "if Foster Wheeler were designated as an agent of * * * the company building the facility." John Evans, one of the original promoters of the refinery and a HIRI stockholder, explained that he had brought in Messrs. Beebe and Quance to review Foster Wheeler's work because when you "stop [start] building a refinery * * * you have to have these people to sort of watch over any engineering company."

In other areas of the tax law, the statutory terms "manufacturer" and "producer" of particular products have been applied to taxpayers having no manufacturing or producing facilities but who contract to have independent businesses produce products for them without their retention of any control over the means and methods of doing the work. *Carbon Steel Co.* v. *Lewellyn*, 251 U.S. 50 (1920) (Person employing independent contractor for manufacturing explosive shells subject to tax on "person manufacturing shells"); *Record Guild of America, Inc.* v. *United States*, 145 Ct. Cl. 686, 172 F. Supp. 676 (1959) (Arrangement with independent company to produce records qualifies taxpayer as "manufacturer" of records for purposes of excise tax); *Warner-Patterson Co.* v. *United States*, 68 Ct. Cl. 237 (1929) (Although taxpayer arranges for independent company to produce lenses, it is the manufacturer for purposes of excise tax); *Polaroid Corp.* v. *United States*, 235 F.2d 276 (1st Cir.), *cert. denied*, 352 U.S. 953 (1956) (Patent-holder who enters into arrangement with third party to produce cameras is manufacturer for purposes of excise tax).

It is evident that the question at issue is not susceptible of resolution merely by referring to an unambiguous meaning of a common phrase but rather must be resolved by the most rational imputation of

congressional intent in the particular context.

The provisions at issue may be traced back to section 167(c) of the Code as it was originally adopted in 1954. Section 167(b) allows deductions pursuant to various methods of accelerated depreciation. Section 167(c) then provides that the new methods apply only in the case of qualified property—

> (1) the construction, reconstruction, or erection of which is completed after December 31, 1953, and then only to that portion of the basis which is properly attributable to such construction, reconstruction or erection after December 31, 1953, or
>
> (2) acquired after December 31, 1953, * * *

The House committee report on the 1954 enactment states that the committee's purpose in adopting this provision was "to limit the application of the liberalized depreciation methods to new assets acquired after the effective date of the bill primarily as a means of minimizing transitional revenue losses and obtaining maximum incentive effect." H. Rep. No. 1337, 83d Cong., 2d Sess. 23 (1954) (1954 U.S. Code, Cong. & Adm. News 4048). *See also* S. Rep. No. 1622, 83d Cong., 2d Sess. 25 (1954) (1954 U. S. Code, Cong. & Adm. News 4656). Although it seems evident from the report that "construction" and "acquisition" were designed to be mutally exclusive and cover the entire field of alternatives during the transitional period, it is not specifically stated whether construction of a building or other facility by a general contractor was to be treated as construction or an acquisition by the taxpayer. But if the limitation on allowance of accelerated depreciation for property already under construction was the "means of minimizing transitional revenue losses," Congress could hardly have intended to confine such construction to that done by taxpayers with their own hands or their own employees. For, in that event, with respect to new plants and facilities the limitation would have been confined largely to those relatively few taxpayers who were in the construction business.[6]

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[6]The infrequency with which corporations have constructed their own plants and facilities is indicated by the fact that there are few cases on the proper allocation of such construction costs to a capital account. Although the income tax laws date back to 1913, that issue was not resolved until 1974. *Commissioner* v. *Idaho Power Co.*, 418 U.S. 1, 17 (1974). *See also Southern Natural Gas Co.* v. *United States*, 188 Ct. Cl. 302, 372-80, 412 F.2d 1222, 1264-69 (1969); *Great Northern Ry.* v. *Commissioner*, 40 F.2d 372 (8th Cir.), *cert. denied*, 282 U.S. 855 (1930). If it were common for corporations to construct their own facilities, it seems likely it would not have taken over 60 years for that issue to be resolved.

The Senate Committee sought to eliminate the limitation as to the use of the liberalized methods of depreciation on only the portion of construction costs incurred after December 31, 1953, permitting instead the entire cost of construction to be depreciated under the new methods if completed and first put into use after December 31, 1953. The Senate's rationale was that the House provision "discriminates against the taxpayer who conducted the construction himself as compared with a taxpayer who purchased a new building after December 31, 1953, which was still in the process of construction on that date," and that the House provision would give rise to difficult administrative problems in dividing costs. S. Rep. No. 1622, 83d Cong., 2d Sess. 29 (1954) (1954 U.S. Code, Cong. & Adm. News 4659). Although the Senate report likewise did not explain directly what it understood by "constructed," if the term were limited to the work done by a contractor's own employees the discrimination the Senate Committee visualized would have been far less invidious than the discrimination which would have existed against taxpayers who conducted the construction with their own employees as compared with the far greater number of taxpayers who had building contractors construct plants and facilities for them. The House provision prevailed in conference, but the House Conference Report provides no further illumination on the matter at issue. H. Conf. Rep. No. 2543, 83d Cong., 2d Sess. 28-29 (1954) (1954 U.S. Code Cong. & Adm. News 5288).

In 1956 the Treasury adopted regulations construing and applying Section 167(b). Regulations on Income Tax, Section 1.167(c)-1, added by T.D. 6182, 1956-1 C.B. 98. Paragraph (a) of these regulations provides in pertinent part as follows:

> If construction, reconstruction, or erection by the taxpayer began before January 1, 1954, and was completed after December 31, 1953, these methods apply only to that portion of the basis of the property which is properly attributable to such construction, reconstruction, or erection after December 31, 1953. Property is considered as constructed, reconstructed, or erected by the taxpayer if the work is done for him in accordance with his specifications.

These regulations are entitled to weight as a substantially contemporaneous construction of the statute by persons most familiar with the statutory purpose. *National Muffler Dealers Ass'n., Inc.* v. *United States*, 440 U.S. 472, 488 (1979); *United States* v. *Correll*,

389 U.S. 299, 307 (1967); *White* v. *Winchester Club*, 315 U.S. 32, 41 (1941). *See also National Broadcasting Co.* v. *United States*, 319 U.S. 190, 224 (1943).

In 1962 Congress first enacted the investment credit. In Section 48(b) of the Internal Revenue Code, it provided that the term "new section 38 property," for which investment tax credit is allowed, means property—

(1) The construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1961, or

(2) Acquired after December 31, 1961, * * *.

In the case of property described in paragraph (1), this section provides there is to be taken into account only that portion of the basis properly attributable to construction, reconstruction, or erection after December 31, 1961. The reports of the committees of both Houses state that:

> The principles applicable under section 167(c) of the code are to be applied under section 48(b) in determining, for example, when the property is acquired by the taxpayer, whether the original use of the property commences with the taxpayer, and the portion of the basis of the property completed after December 31, 1961, which is attributable to construction, reconstruction, or erection after that date. (H. Rep. No. 1447, 87th Cong., 2d Sess., A21 (1961) (1962-3 C.B. 519); S. Rep. No. 1881, 87th Cong., 2d Sess. 158 (1961) (1962-3 C.B. 862).)

Under familiar principles of statutory construction, in the interpretation of section 48(b), it is fair to impute congressional approval to the Treasury Regulations adopted with respect to Section 167(b). *See Comm.* v. *Portland Cement Co.*, 450 U.S. 156, 169 (1981); *Corn Products Refinery Co.* v. *Comm.*, 350 U.S. 46, 53 (1955); *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, 116-17 (1936). *See also United States* v. *Leslie Salt Co.*, 350 U.S. 383 (1956).

In 1964 the Treasury adopted regulation section 1.48-2 with respect to the investment credit which reiterated the pertinent provisions of depreciation regulations. (T.D. 6731, 1964-1 C.B. 11) as follows:

> (b) *Special rules for determining date of acquisition, original use, and basis attributable to construction, reconstruction, or erection.* For purposes of paragraph (a) of this section, the principles set forth in paragraph (a) (1) and (2) of § 1.167(c)-1 shall be

applied. Thus, for example, the following rules are applicable:

(1) Property is considered as constructed, reconstructed, or erected by the taxpayer if the work is done for him in accordance with his specifications.

In 1966 Congress suspended both the investment credit, and, in the case of certain real property, the allowance of accelerated depreciation for the period beginning October 10, 1966, and ending December 31, 1967. (I.R.C. § 48(h), as added by the Act of November 8, 1966, Pub. L. 89-800, 80 Stat. 1508.) Both the terms of the statute and statements in the committee report indicate quite clearly that Congress contemplated that a taxpayer could engage in the construction of Section 38 property by contracting for it rather than by using his own employees. Section 48(h)(1) provides that "suspension period property" shall not be treated as Section 38 property. Subparagraph (2) then states that the term "suspension period property" means Section 38 property—

(A) The physical construction, reconstruction, or erection of which begins either during the suspension period or *pursuant to an order placed during such period,* or

(B) which is acquired by the taxpayer either during the suspension period or *pursuant to an order placed during such period.*[7] (Emphasis added.)

If Congress had understood property constructed for the taxpayer pursuant to an order placed by the taxpayer with a contractor to be acquired property, there would have been no need for the last clause of subparagraph (A)—the described situation would have been covered by subparagraph (B).

In addition, subparagraph (3) of the same subsection provides that—

To the extent that any *property is constructed,* reconstructed, erected, or acquired *pursuant to a contract* which was, on October 9, 1966, and at all times thereafter, binding on the taxpayer, such property shall not be deemed to be suspension period property. (Emphasis added.)

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[7]The House Committee Report explains that the intent was to suspend investment credit with respect to property ordered to be constructed even if construction was begun after the end of the suspension period. H. Rep. No. 2087, 89th Cong., 2d Sess. 19 (1966), 1966-2 C.B. 917.

Similarly, if Congress had understood that property constructed for the taxpayer by a contractor is acquired property, it would only have referred to property *acquired* pursuant to a prior contract.[8] Lest there be any question that the reference to a contract in section 48(h)(3) might be reference to a contract other than a construction contract, the House Report states that "[A] contract meets the requirements of paragraph (3) only if it is with a person who is to construct, reconstruct, erect, or supply the property." H. Rep. No. 2087, 89th Cong., 2d Sess. 31 (1966) (1966-2 C.B. 917).

The 1966 Senate Committee Report contains many statements inconsistent with the notion that the distinction between construction and acquisition is that the former can only be done by the taxpayer himself or by his employees while the latter covers work performed by anyone else for the taxpayer. It states that investment credit and accelerated depreciation are not "to be denied with respect to property constructed or acquired pursuant to a contract which was binding on the taxpayer before the beginning of the suspension period and at all times thereafter." S. Rep. No. 1724, 89th Cong., 2d Sess. 3 (1966) (1966-2 C.B. 926). An exception to the suspension is made "with respect to property acquired or constructed pursuant to a contract binding on the taxpayer at the time that the suspension became effective." *Id.* at 16 (1966-2 C.B. at 937). This result is stated to be required in fairness to taxpayers who were unaware of the forthcoming suspension of the credit at the time they entered into "agreements to construct or acquire property eligible for the investment credit which they cannot now cancel without liability for damages." *Id.* at 16-17 (1966-2 C.B. at 937).

Under the heading "Rules Common to Suspensions of Investment Credit and Accelerated Depreciation" the Senate Committee Report states:

> If the physical construction has commenced before the beginning of the suspension period, *whether the construction is performed by the taxpayer or by someone else under a contract with him*, the entire building is to be eligible for the accelerated depreciation.

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[8] Section 2 of the 1966 Act also amended section 167 of the Code to suspend the accelerated depreciation provisions in the case of real property which is not section 38 property (as defined in section 48(a)) under circumstances similar to those set out in Section 48(h)(1)(A), and provided for the application of rules similar to those provided by section 48(h)(3) under regulations provided by the Secretary of the Treasury or his delegate. Pub. L. 89-800, 80 Stat. 1513.

(S. Rep. No. 1724, 89th Cong., 2d Sess. 23-24 (1966) (1966-2 C.B. 937).) (Emphasis added.)

And—

> Under the bill, the investment credit and accelerated depreciation are not suspended with respect to property which is *constructed*, reconstructed, erected, or acquired *pursuant to a contract* that was binding on the taxpayer at the close of October 9, 1966, and at all times thereafter. This provision applies only to *contracts in which the construction*, reconstruction, erection, or acquisition of property *is itself the subject matter of the contract*, and does not apply to a contract with a person other than the builder or supplier under which the taxpayer becomes obligated to construct, reconstruct, erect, or acquire property. (*Id.* at 24-25 (1966-2 C.B. at 943).) (Emphasis added.)

In 1969 Congress added Section 49 to the Internal Revenue Code which repealed the investment credit entirely. (Section 703, Tax Reform Act of 1969, Pub. L. 91-172, 83 Stat. 660.) Section 49(a) provided that the term "Section 38 property" does not include property—

> (1) The physical construction, reconstruction, or erection of which is begun after April 18, 1969, or
>
> (2) which is acquired by the taxpayer after April 18, 1969, other than pre-termination property.

Section 49(b) then states:

> Any property shall be treated as pre-termination property to the extent that such property is *constructed*, reconstructed, erected, or acquired *pursuant to a contract* which was, on April 18, 1969, and at all times thereafter binding on the taxpayer. (Emphasis added.)

Section 49(b) also recognizes that property may be "constructed * * * pursuant to a contract" with a taxpayer rather than by the taxpayer himself without it necessarily being deemed an acquisition.

This congressional understanding is reinforced by the legislative committee reports. The House report states that—

> Under the bill the investment credit is to be available with respect to property which is constructed, (reconstructed or erected) or acquired pursuant to a contract that was binding on the taxpayer at the close of April 18, 1969, and at all times thereafter. This provision applies only to contracts in which the construction, reconstruction, erection, or acquisition of property is itself the

> subject matter of the contract and does not apply to a contract with a person other than the builder or supplier under which the taxpayer becomes obligated to construct, reconstruct, erect, or acquire the property. (H. Rep. No. 413, 91st Cong., 1st Sess. 183 (1969) (1969-3 C.B. 314).)
>
> It further states:
>
> If a taxpayer who had entered into a contract for the construction of property prior to April 19, 1969, completes the contract himself because of the default of the other contracting party, the taxpayer is considered to have a binding contract to the extent that he was bound on the contract prior to the default. (H. Rep. No. 413, 91st Cong., 1st Sess. 184 (1969) (1969-3 C.B. 315).)

See also Senate Report No. 552, 91st Cong., 1st Sess. 229-230 (1969) (1969-3 C.B. 568-569, 570).

As already noted, in providing for the restoration of the investment credit in 1971, Section 50 of the Internal Revenue Code makes a division of the classes of property similar to that made in the prior enactments: (1) property the construction, reconstruction, or erection of which (A) is completed by the taxpayer after August 15, 1971, or (B) is begun by the taxpayer after March 31, 1971;[9] and (2) property acquired by the taxpayer (A) after August 15, 1971, or (B) after March 31, 1971, pursuant to an order placed by the taxpayer after March 31, 1971. A taxpayer who places into service constructed property described in subsection (1)(A), which is not begun after March 31, 1971, is only entitled to investment credit for the portion of its cost attributable to construction after August 15, 1971. All other constructed property generates a credit for its full cost. Plaintiff claims, however, that property constructed for the taxpayer by an independent contractor is entitled to the full credit, while property constructed for it by its own employees is only entitled to the limited credit.

Plaintiff's interpretation of the statutory language is contrary to the applicable Treasury regulations and, as has already been noted, to the regulations under the 1954 and 1962 enactment interpreting similar statutory language. Furthermore, it is inconsistent with the

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[9]The March 31, 1971 alternative date was employed as an accommodation to those who relied on assurances as to the availability of the investment credit made by the Secretary of the Treasury. See H. Rep. No. 533, 92 Cong., 1st Sess. 7 (1971) (1972-1 C.B. 500).

Congressional understanding of such language implicit in the 1954, 1962, 1966, and 1969 acts and accompanying committee reports. Moreover, it is extremely difficult to see what purpose Congress would have in discriminating against taxpayers who conduct their own construction and in favor of those who follow the more usual course of hiring contractors in the construction business to do their construction.

III.

Plaintiff relies on the authority of the decisions in *Public Service Co. of New Mexico* v. *United States*, 431 F.2d 980 (10th Cir. 1970), and of *Lykes Bros. S.S. Co., Inc.* v. *United States*, 206 Ct. Cl. 354, 513 F.2d 1342 (1975).[10] Both of these decisions involve the meaning and application of Section 48(b) of the Code, which deals with the phasing in of the investment credit in 1962, while the instant case involves Section 50, which deals with the restoration of the credit in 1971. Although the division between property "constructed" by the taxpayer and property "acquired" by the taxpayer was considered in both cases, neither decision had the benefit of the light cast on the subject by the intervening 1966 and 1969 enactments.

Plaintiff's primary reliance is on *Public Service Co. of New Mexico, supra*. There an electrical utility company claimed investment credit under the 1962 act for the entire cost of a new electrical generating plant, the construction of which was begun in 1960 and completed in 1962, on the theory that it had acquired the plant from the construction company in 1962 rather than constructed it itself. The evidence summarized by the circuit court was that in January 1960, the Public Service Company of New Mexico ("Public Service") had entered into a cost-plus-fixed fee contract with an established electrical construction company for the latter to furnish all the engineering and construction facilities necessary to turn over a complete operating unit to Public Service on the taxpayer's own land. The plant was designed by the construction company, but in complete coordination with Public Service's representatives. Public Service paid for, was the legal owner of and assumed the risk with respect to

[10] *Pacific Far East Line, Inc.* v. *United States*, 206 Ct. Cl. 378, 513 F.2d 1355 (1975), decided the same day as *Lykes*, involves substantially the same facts and reasoning as *Lykes*.

the major plant components. The contractor supplied field supervision of construction, provided all mechanics, craftsmen and laborers, and performed all of the construction work necessary to deliver a complete operational unit as promised, and its field superintendent took orders only from his company.

The circuit court held that, for purposes of Section 48 of the Code, Public Service had not constructed the plant over a period overlapping the effective date of the 1962 investment credit but had acquired it in 1962 upon its completion because it had not done the work with its own employees but through an independent contractor. However, the reasoning of the circuit court is flawed by its application of an improper legal standard. The court stated that it derived its test of construction or acquisition from Treasury Regulations § 1.48-2(b)(1), which, as already noted, states that "Property is considered as constructed, reconstructed, or erected by the taxpayer if the work is done for him in accordance with his specifications." The Tenth Circuit misconstrued that regulation by equating it to the common law master-servant test of "whether the employer has the right to control the manner in which the details of the work are to be accomplished," and concluded that "the purpose of this regulation is to distinguish between work done by independent contractors and mere employees." (431 F.2d at 983).[11]

There is no necessary equivalence between contracting to have construction done pursuant to one's own specifications and having the right to control the means and manner by which the work is performed. It is possible to have either an employee or an independent contractor perform work in accordance with specifications. The holding that construction done for the taxpayer by an independent contractor can never be construction by the taxpayer but is always an acquisition by the taxpayer is certainly inconsistent with the understanding of Congress in 1966 and 1969 when it enacted the statutes suspending and terminating temporarily the investment credit.

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[11] The court's application of that standard was stated as follows (431 F.2d at 983):

> Only if it had authoritative control with respect to the manner and means in which and by which the details of the work were to be performed would the company be limited to a credit on the basis of construction costs after December 31, 1961.

The Tenth Circuit went on to evaluate the case under the master-servant standard set forth in several New Mexico tort liability cases. *Id.*

The facts in *Lykes* were very different from those in both *Public Service Co. of New Mexico* and the instant case. In *Lykes* the property was not a plant or other structure built on and attached to the taxpayer's land but four vessels constructed and assembled by the Bethlehem Steel Company at a shipyard more than a thousand miles away from the taxpayer's premises and delivered only after completion. Under the contract, Bethlehem was required to furnish all labor and materials, to perform all the work and to deliver the vessels at its own risk and expense. Until delivery of the completed vessels, none of the materials and equipment was owned by the Lykes Bros. Steamship Company (''Lykes''). The court also found that the governing specifications followed by Bethlehem were not under the taxpayer's control but under the control of the Federal Maritime Board, which subsidized the construction. Thus the court thought that the taxpayer's control over the construction of the vessels was ''remarkably less than that of an ordinary buyer.'' (206 Ct. Cl. at 372, 513 F.2d at 1352)

Since the *Lykes* case also arose under the 1962 investment credit statute and not the 1971 act and since the Congressional understanding of the terms ''constructed by the taxpayer'' and ''acquired by the taxpayer,'' as reflected in the enactment and legislative history of the 1966 and 1969 investment credit legislation, was not brought to the court's attention, it is difficult to assess whether or not the result in *Lykes* would have been the same had the 1971 statute been applied to the same facts. But it is clear that in *Lykes* this court did not accept as correct the holding of the Tenth Circuit that the test of whether property is constructed by the taxpayer for purposes of I.R.C. § 48 is whether the work is performed by the taxpayer's employees or by an independent contractor. There being no doubt that Bethlehem was never Lykes' employee, had the court applied the master-servant test to Lykes and Bethlehem, it would have made short shrift of the Government's defense. Instead, the court upheld the validity of the Treasury regulation but put its own gloss upon it, stating (200 Ct. Cl. at 371, 513 F.2d at 1351)—

> We agree with the Tenth Circuit that the right of control is the most important factor to be considered in determining whether the work is done for the taxpayer ''in accordance with his specification'' [Treasury Regulations 1.48-2(b)(1)] However, we need not go so far as to hold that the taxpayer is entitled to recover upon a finding, without more, that the Bethlehem Steel Company filled

the role of an independent contractor.

Since the right of control to which the Tenth Circuit made reference is "the right to control the manner in which the details of the work are to be accomplished," the traditional common law master-servant test, that could not have been the test which this court applied in determining whether or not the property constructed by Bethlehem as an independent contractor was "in accordance with [the taxpayer's] specifications" and hence constructed "by the taxpayer." What the court was concerned with in *Lykes* was the absence of any kind of control over the vessels prior to delivery which would show "a sufficient nexus between the construction and the taxpayer for the construction to be 'by the taxpayer' within the meaning of section 48(b)(1)." (206 Ct. Cl. at 370, 513 5.2d at 1350)

In *Lykes*, the court was of the view that Maritime's pervasive control over the ships' contracts, design and construction was inconsistent with retention of such control by the taxpayer. It found that "the Government exercised a large degree of control over the contract at all stages from the beginning to the final completion of the project," and noted that "Maritime had the right to control the design specifications in every detail." (206 Ct. Cl. at 372, 513 F.2d at 1351) The court noted that Maritime's disapproval of plaintiff's proposed horsepower for the vessels had resulted in a power increase; that when plaintiff later submitted the proposed contract plans and specifications, Maritime "critically reviewed" them and made almost 400 adverse comments in great detail, which necessitated additional negotiations by plaintiff to obtain approval of the specifications; and that Maritime supervised the awarding of the construction contracts, and had the final word on any post-award amendments to the specifications. Maritime had the right of final approval over whether the vessels were built consistently with the contract requirements. The court also found that Maritime exercised its control in numerous instances. There is no evidence here of Government control so pervasive as to supersede plaintiff's control over the specifications or any other aspect of the project.

It is clear that the facts of the instant case are wholly distinguishable from those in *Lykes*, and that if control is required to establish a nexus between the taxpayer and the construction at issue sufficient control exists here. Here the taxpayer provided the land, the zoning, the permits, licenses, clearing, grading, and soil and foundation analysis for construction of the refinery and the related facilities.

while Lykes provided none of these. HIRI, but not Lykes, paid for all of the major items of equipment and supplies and retained title to them from the time of shipment by the vendors as well as of all work completed or in progress, and bore all the risk of their damage or loss. The assumption of such risks by the taxpayer necessarily implies some control by it over the details of construction, lest HIRI be placed in the tenuous position of bearing all the risks but being unable to guard against loss therefrom.

HIRI dictated the design specifications of the facility, determined such essential aspects as the type of crude oil to be refined, how that oil was to be received, the product slate, and the daily capacity of the refinery. It unilaterally selected the major contractors who would perform the construction of the different parts of the facility. In regard to the refinery plant, under the initial cost plus reimbursement arrangement with Foster Wheeler, HIRI approved all vendors and subcontractors; and even under the subsequent fixed price contract it retained a qualified right to change vendors and subcontractors.

HIRI had the right to review the contract plans and work drawings prepared by its general contractor, Foster Wheeler. Although due to the size of its staff of experts (principally Beebe, Quance and Bean), HIRI was unable to inspect more than a small percentage of the documents, HIRI still had the right to approve or disapprove them. It also had the right to make changes in the Foster Wheeler plans and drawings, subject to the obligation to pay for additional costs associated with the modifications. As previously pointed out, just prior to the execution of the fixed-price contract with Foster Wheeler, HIRI initiated most of the 23 scope changes in the refinery project which reduced the cost of the original Foster Wheeler design by $1 to $2 million. And even after the execution of the fixed-price contract, HIRI was responsible for most of the 15 major modifications to the contract plans and specifications. All of the foregoing is in conspicuous contrast with the situation in *Lykes* where control of the specifications and plans resided primarily in a third party, Maritime, which superseded Lykes in the role of principal in the construction contract.

In addition, during construction plaintiff's representatives inspected the work product at the building site regularly several times per week to verify its conformity with the specifications and the quality of the workmanship. No such practice was observed in *Lykes*—the responsibility for such inspection prior to delivery was that of Bethlehem.

Furthermore, HIRI possessed sufficient control over the construction of the offshore components (the marine terminal and products pipelines) to be considered the constructor of that property for purposes of the investment credit statute. HIRI purchased much of the materials needed for the construction of the offshore components. It entered into contractual agreements with Bechtel Corporation and Williams Brothers Engineering whereby the contractors agreed to act as HIRI's representative in supervising the construction of the terminal and products pipelines. HIRI retained complete control over the design of the offshore components, had the right to review and approve all work drawings and assumed the risk of loss of the building materials and work completed.

Thus, if the standards invoked by the court in *Lykes* in applying the 1962 statute remain applicable to the 1971 statute, here it is concluded that on balance there was "a sufficient nexus between the construction and the taxpayer for the construction to be 'by the taxpayer'" within the meaning of section 50(a)(1)(A) and the refinery was not merely purchased by the taxpayer.

Additional comment is appropriate with respect to another part of the *Lykes* rationale, upon which plaintiff also places emphasis—that the investment credit was remedial legislation, designed to encourage the modernization and expansion of the nation's production facilities, to improve the country's economic potential, increase job opportunities and better the country's competitive position in the world economy, and that such remedial legislation should be construed liberally in order to effectuate its purpose. (206 Ct. Cl. at 375, 513 F.2d at 1353)

In *Lykes*, the court was commenting upon the purpose of the original investment credit and not the 1969 termination and 1971 restoration. In 1969 Congress terminated the original credit because it was of the opinion that inflation was being fueled by excessive investment in industrial plants and equipment. The committees of both Houses concluded that the availability of the investment credit aggravated this situation, stating:

> [T]he stimulus to investment which is provided by the credit contributes directly to these pressures. In addition to its effect on inflationary pressures, the present level of investment cannot be maintained for more than a short period of time and it is important for the long-run vitality of the economy to keep the level of investment on a steady growth plan.

* * * * *

> [A] tax credit of this type which encourages spending for investments is inappropriate and inconsistent with national economic policy that applies a surcharge on individual and corporation income tax liabilities, * * *, to restrain spending by business and consumers.

H. Rep. No. 413, 91st Cong., 1st Sess. 178 (1969) (1969-3 C.B. 311). *See also* S. Rep. No. 552, 91st Cong., 1st Sess. 224 (1969) (1969-3 C.B. 565). Additionally, Congress felt that the investment credit made it necessary to impose more severe monetary restraints on other segments of the economy than would otherwise have been required, causing tight fiscal policy to have a disproportionate negative impact. S. Rep. No. 552, 91st Cong., 1st Sess. 224 (1969) (1969-3 C.B. 565).[12]

Most of the detailed planning of the taxpayer's facility occurred during the period after the credit had been terminated. Accordingly, HIRI moved ahead with its project not during a period when Congress was encouraging investment or neutral on the subject but at a time when Congress, by various mechanisms, was actually discouraging large capital expenditures. Unlike the taxpayer in *Lykes*, HIRI acted at a time when there was an express Congressional policy against large-scale industrial development.

When it restored the investment credit in 1971, Congress demonstrated an intent to make the credit fully available only where it conceivably provided an incentive to invest. There is no indication that Congress sought to provide a tax windfall to businesses such as HIRI, which had made operative decisions to invest during the period when the credit was unavailable, and not thought likely to become available.

The legislative history of section 50(a) serves to illustrate this point. Section 50(a) provides an investment credit for property the construction of which is begun after March 31, 1971 (or completed after August 15, 1971) or which is acquired pursuant to an order established to have been placed after March 31, 1971. Such property is exempted from the transitional rule of section 50(b). Congress explained that the credit was extended to post-March 31, 1971 costs:

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[12]Congress chose to repeal rather than suspend the credit because it did not want businessmen to merely postpone their investments a few months, anticipating a future restoration of the credit. H. R. Rep. No. 413, 91st Cong., 1st Sess. 179 (1969) (1969-3 C.B. 312).

> to avoid discrimination against those who took action on or after that date to acquire eligible assets on the basis of assurances as to the availability of the credit made by the Secretary of the Treasury, after consultation with the ranking members of the Congressional taxwriting committees.
>
> H. Rep. No. 533, 92d Cong., 1st Sess. 7 (1971) (1972-1 C.B. 500).

As this passage indicates, Congress did not arbitrarily choose the March 31, 1971 cut-off date, but rather selected that date as an accommodation to those businesses which had potentially relied on the existence of the credit in making investment decisions. HIRI did not so rely.

Thus allowance of the investment credit pursuant to a "liberal" construction of the 1971 enactment would not necessarily be in furtherance of Congressional intent, but would be more in the nature of Congress giving an inch and the taxpayer taking a foot. It would also discriminate unfairly against other taxpayers who pursuant to national policy were cut off from investment credit from 1969 to the 1971 effective dates for restoration of the credit.

IV.

Alternatively, plaintiff contends that even if it is deemed to have constructed the facility itself, pursuant to sections 50(a)(1)(B) and 50(b), the entire basis of the marine terminal and products pipelines components should be creditable, because construction of these components did not commence until after March 31, 1971.[13] Plaintiff urges this court to treat each of the component parts of the facility (*i.e.*, the refinery, the marine terminal, and the products pipelines) separately, and to apply the transitional rule of section 50(b) only to the refinery. Defendant, for its part, maintains that the marine terminal, refinery, and products pipelines constitute a single integrated construction project, and that work on the refinery, and thus necessarily on the marine terminal and products pipeline, commenced prior to April 1, 1971. Neither party cites any authority in support of its argument. Nothing in the statutes or regulations deals specifically with what is a single property for purposes of Section 50.

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[13] Recall that the transitional rule of section 50(b), which would limit plaintiff to credit for the portion of its costs attributable to construction after August 15, 1971, only applies to property "the construction, reconstruction, or erection of which is begun before April 1, 1971."

Absent any explicit statutory standard, it appears appropriate to look to the definition of "section 38 property."

Section 48(a)(1) defines "section 38 property" as including:

(A) tangible personal property, or

(B) other tangible property (not including a building and its structural components) but only if such property—

(i) is used as an integral part of manufacturing, production or extraction or of furnishing transportation, communication, electrical energy, gas, water, or sewage disposal services, or

(ii) constitutes a research or storage facility used in connection with any of the activities referred to in clause (i).

* * *

Treasury Regulations section 1.48-1(d)(4), promulgated under this section, provides that property is used as an integral part of a manufacturing process if "it is used directly in the activity and is essential to the completeness of the activity."

The marine terminal qualifies as section 38 property because it is used to transport raw materials to the refinery and it is therefore integral to the refinery's manufacturing or production process. The products pipelines connect the refinery with plaintiff's storage tanks at Pearl Harbor, Honolulu Harbor, and the Honolulu airport and therefore qualify either because they are essential to the completeness of the manufacturing activity or because they constitute part of a storage facility used in connection with the manufacturing activity. If this relationship is necessary to qualify the offsite components as section 38 property under section 48(a)(1), it is reasonable to impute to Congress the intent to treat them as a single property for purposes of applying the effective date and transitional rule of section 50.

Apart from section 48(a)(1), if, as a practical matter, the facility could not function as designed without each of the components at issue, it is reasonable to treat them as parts of a single property for purposes of section 50. Each of the offsite components is essential to the operation of the petroleum refinery—the refinery could not function without a system for receiving the crude oil and removing and storing the completed products. The marine terminal fills the first role, the products pipelines the second. Thus the two components, in conjunction with the refinery itself, functionally form a single property. All were placed in operation concurrently and it is reasonable to treat them as jointly having been begun when construction was begun

on the first component.

Even more persuasive of this result is that if plaintiff's argument for treatment of each of the offset components as a separate property the construction of which was begun after March 31, 1971, were adopted, it would distort the statutory purpose. As shown at page 33, *supra*, Congress allowed the full investment credit for property the construction of which was begun after March 31, 1971, because some taxpayers had initiated such action in reliance on assurances by the Secretary of the Treasury after consultation with the ranking members of the Congressional taxwriting committees that Congress would restore the investment credit as of that time. There is no evidence that taxpayer's initiation of construction of the offsite components was based on such reliance. Indeed, it is rather obvious that the contrary was the case. They were part of a single project to which the taxpayer had committed itself much earlier when it entered into the original arrangement with Foster Wheeler, and when Foster Wheeler began construction in January 1971.[14]

In arguing for separate treatment under section 50(a) for each of the three components, plaintiff places emphasis on the fact that they were constructed under three different contracts with different contractors. But such an argument must necessarily be rejected because its allowance would frustrate the operation of the transitional rule in section 50(b) limiting the credit on property completed after August 15, 1971 (where begun before March 31, 1971) to only that portion of the basis attributable to construction after August 15, 1971. If allowed, the taxpayer could use the post-March 31, 1971 purchase date of each item of equipment and each separate subcontract (electrical, plumbing, steel work, etc.) as a basis for avoiding the limitation. It would result in invidious discriminatory treatment among taxpayers in substantially the same position.

FINDINGS OF FACT

1. Honolulu Gas Company, Ltd., currently known as Gasco, Inc., is a local gas distribution public utility. In the early 1960's it manufactured its gas from fuel oil, and under the direction of Mr. Paul Joy, its vice president for engineering, it explored ways in which to expand and diversify its energy business by refining and selling

[14]The first contract with Bechtel for engineering services in connection with the marine terminal is dated August 12, 1970.

other petroleum products. Mr. John K. Evans is an independent consultant in the petroleum industry, who later became a minority stockholder in plaintiff. Based on his extensive experience in the oil business, Mr. Evans was convinced of the desirability of locating refineries close to markets they would serve and of the great need for such facilities in several areas of the United States, one of which was Honolulu.

2. Mr. Evans did not have the experiential background to run a refinery nor the means to finance the cost of construction. He therefore sought suitable partners for such a venture who would have the resources and organization to fund and operate the enterprise. Mr. Evans met with the governor of Hawaii, who directed him to Mr. James Gary, president of Honolulu Gas. During early 1968 Messrs. Joy, Gary and Evans discussed and were actively involved in initial planning and organization of the project. Mr. Evans had previously discussed his plans with Foster Wheeler Corporation, a large engineering consulting firm having experience in oil refinery construction. Accordingly, representatives of Foster Wheeler participated in the early planning of the Hawaii project.

3. An essential part of the planning was to have the refinery constructed in an area designated by law as a foreign trade zone, so as to avoid customs duties on petroleum imports and state taxes on petroleum products so long as they remained in bond or in the foreign trade zone or were sold to outgoing vessels. Another essential part of the plan was the sale of refined products, such as jet fuel, diesel fuel, gasoline and fuel oil, to the military at Pearl Harbor as a substitute for purchases which the latter might otherwise make abroad. A third aspect of the plan was the limitation of the initial refinery capacity to less than 30,000 barrels per day so as to qualify it for a "small business" set aside in government procurement with attendant bidding advantages.

4. (a) Hawaiian Independent Refinery, Inc. was incorporated under the laws of the State of Delaware on May 27, 1968, to develop and operate such a refinery facility at Barber's Point on the island of Oahu, in an area that would be the subject of an application for designation as a Foreign Trade Sub-Zone.

(b) The site of the refinery is in Campbell Industrial Park, located 13 miles from Honolulu. In 1968, HIRI obtained a commitment to a lease of this property for a term of 55 years. It also began to obtain the permits and licenses required for future construction.

(c) On August 2, 1968, a foreign trade zone application was filed by the Governor of Hawaii to establish a subzone in the foreign trade zone at Barber's Point. The application was primarily prepared by HIRI's employees with some technical assistance by Foster Wheeler. On April 20, 1970, the application was approved, and on May 7, 1970, the Secretary of the Interior signed an order granting the facility a foreign crude oil import allocation.

5. (a) As originally conceived, the facility was to include three major components: a grass-roots, straight run oil refinery to be located at Barber's Point; a marine terminal consisting of an offshore tanker-mooring facility located about 2 miles out from the refinery, with an underwater/underground pipeline system extending from the mooring to the refinery; and two refined petroleum products pipelines to transport jet fuels and multi-purpose distillate produced by the refinery from the Barber's Point pump station to various storage areas in the Honolulu area.

(b) The operation of the facility involves the receipt of crude oil from tankers moored offshore, and the transmission of the oil through pipelines to the onshore refinery. Location of the mooring site in deep water permits the unloading of tankers of much greater capacity than can be accommodated in the harbor. The crude oil is initially piped to storage tanks on the refinery's premises and is then pumped into a "crude unit," where, by the application of heat and through the use of distillation columns and trays at different elevations, it is fractionated into separate products. Some of the distilled products are piped directly into storage tanks, while others are further processed through a Merox unit for the removal of sulphur. The finished products are then transported to storage area tanks and terminals through products pipelines. One products pipeline runs 13 miles to a storage tank at the Pearl Harbor naval base; another runs to a tank at the Honolulu airport. These carry primarily jet fuel.

6. The facility was designed initially to refine 29,500 barrels of crude oil per day. HIRI anticipated expansion of the capacity of the refinery as the market for its products developed.

7. The marine terminal and the products pipeline were designed specifically and exclusively for use in connection with the refinery. They are physically tied in to the refinery. All three components of the facility are part of a single functionally-integrated system. The two offsite or outside-the-fence components have no practical utility to plaintiff apart from the refinery and each was designed specifically

and exclusively for use in connection with it.

8. (a) From the time of its incorporation in 1968 until shortly before the refinery became operational in 1972, HIRI's entire business and all of its affairs were devoted to the planning, construction and financing of the facility.

(b) In 1968, Mr. Evans and Mr. Gary selected Foster Wheeler to be the consultant in the formulation of preliminary studies on the engineering and economics of the contemplated refinery. Initially, Foster Wheeler was involved in the preparation of plans and technical studies which were used in support of HIRI's foreign trade zone application. These related to economic feasibility, yields from various types of crude oil, and engineering and petroleum technology.

9. The initial step in designing and building the facility was the determination of the types of crude oil the plant would be designed for, the quantity of crude oil to be obtained, how the crude oil was to be received, how the finished petroleum products were to be delivered to military and civilian customers, the daily capacity of the facility to be achieved, the general plan and layout of the facility, the types of products to be made and marketed, and the major component parts of the planned facility to be constructed. HIRI's officials made all of these decisions.

10. HIRI did not have the personnel to do the design and process engineering itself, nor did it employ the supervisors and workmen needed actually to construct the facility. Accordingly, it retained three firms to serve as design engineers and construction supervisors: Foster Wheeler for the refinery; Bechtel, Inc. for the marine terminal; and an affiliate of Williams Brothers Engineering Co. for the products pipelines. HIRI's agreement with Foster Wheeler also contemplated that the latter would act as the prime contractor for the actual construction of the refinery. For the construction of the marine terminal plaintiff contracted with Healy Tibbets Construction Co., and for construction of the products pipelines plaintiff contracted with Hood Corporation. For the foundation study and soil tests at the refinery site, plaintiff retained Dames & Moore for approximately $70,000; and for the site clearing and grading work plaintiff hired E. E. Block, Ltd. for $22,000.

11. Before HIRI and Foster Wheeler executed a formal contract in June 1971, the parties proceeded on the basis of an understanding that Foster Wheeler would commence preparatory work on the refin-

ery and be compensated on a cost-reimbursement basis until such time as a definitive estimate of cost acceptable to HIRI could be made. The lending institutions which would finance the project insisted on a guaranteed maximum price contract, but prior to its execution there was no assurance that the parties would be able to reach agreement on a maximum or fixed price for construction of the refinery.

12. (a) From the outset, HIRI's officials were concerned that Foster Wheeler's engineers might overdesign the refinery in order to obtain additional protection on their warranty that the facility would produce certain products in specified quantities (a performance guarantee). HIRI's representatives were also worried that, if left to its own, Foster Wheeler might not design an oil refinery geared entirely to HIRI's specifications.

(b) To address these concerns, HIRI hired as its vice-president and general manager, Earl Beebe, a retired oil refinery operator with 48 years of experience in the field of refinery construction and operation. Mr. Beebe's responsibility was to oversee the design and construction of the entire facility, and specifically to ensure that the refinery being designed by Foster Wheeler would be operable efficiently by HIRI and conform to HIRI's planned purposes. At the time Mr. Beebe assumed his duties, the project was still in the planning stage and no construction had commenced.

(c) In September 1970, Mr. Beebe hired Edward Quance, an experienced refinery operator, manager process designer, trouble-shooter, and startup engineer, to serve as HIRI's project engineer for the refinery, and Bruce Bean, a mechanical engineer employed by Honolulu Gas, who had previously worked on the planning of the facility, to serve as project engineer for the two offsite components.

(d) Mr. Quance's duties included assisting Mr. Beebe by doing the engineering work necessary to check out Foster Wheeler designs and specifications to be sure that they would be satisfactory, and auditing and inspecting Foster Wheeler's work product. Additionally, he was required to check in detail those Foster Wheeler designs, plans and specifications he thought important and to suggest alternatives to Foster Wheeler in order to achieve the results HIRI wanted. It was also anticipated that Mr. Quance would do some general design and engineering work himself.

13. Prior to the hiring of Mr. Quance, the Foster Wheeler en-

gineering staff had begun working on preliminary process and project engineering for the refinery, and Mr. Beebe had been reviewing their engineering flow diagrams to determine if they reflected the way HIRI wanted to do things from an operating standpoint. Shortly after Mr. Quance began working, Foster Wheeler, acting as HIRI's purchasing agent, placed orders in HIRI's name for the refinery's tankage and fractionating columns, approximately 5 million dollars worth of materials.

14. From the inception of the project Foster Wheeler acted as purchasing agent for plaintiff, placing purchase orders in HIRI's name for all of the major items of equipment and supplies and for subcontracting services, and HIRI approved all such purchases and subcontracts. For the first 2 to 3 months payments for materials were drawn by Foster Wheeler on a checking account maintained by HIRI for that purpose. After HIRI and Foster Wheeler entered into the fixed price contract in June 1971, Foster Wheeler used HIRI's progress payments to pay for purchases. Before and after the fixed price contract was executed, HIRI also had the right to approve all vendors. Mr. Beebe devoted a substantial portion of his time to checking orders and disbursements for supplies and equipment, particularly during the period preceding the execution of the fixed-price Foster Wheeler contract.

15. At the peak of its planning, designing and drawing work, 100 Foster Wheeler employees in its home office worked on this project, of which 25 were engineers and 50 draftsmen. They devoted a total of 20,000 to 25,000 man-days to the project. It is not clear how many additional man-days were devoted to it in the field.

16. (a) As Foster Wheeler developed and drafted drawings and specifications for the oil refinery, it routinely made the documents available to HIRI's personnel for their examination and comments. Due to the vast amount of documentation produced by Foster Wheeler's engineers and draftsmen, Messrs. Beebe and Quance could only check the drawings and specifications they deemed important and spot check others.

(b) During the design formulation period Mr. Beebe made at least 10 trips, lasting from a few days to one week each, to Foster Wheeler's New Jersey office to review the latter's work in progress, spending a minimum of 45 full days working on Foster Wheeler's premises. Mr. Quance is not certain as to the total number of his trips and total time spent but he made at least one trip a month from

October through December 1970. During these visits, HIRI's representatives customarily approved designs and drawings and reviewed such items as schedules, progress reports, specifications, models, purchase orders and vendors lists.

(c) The parties also communicated with each other on an almost daily basis by either mail, telex, or telephone. Not all of the correspondence has been preserved, but the communications between HIRI and Foster Wheeler were numbered sequentially, and as of January 1972 Foster Wheeler had sent to HIRI 475 letters of telexes and HIRI had sent Foster Wheeler 305.

(d) When a difference of opinion arose between the parties, the subject would be discussed and mutally resolved. Generally, Foster Wheeler would accept HIRI's suggestions as long as HIRI agreed to pay for any substantial additional costs associated with the change and if the decision did not prevent Foster Wheeler from meeting its construction schedule and process guarantees. However, Foster Wheeler would not stop its designing work while waiting for HIRI's approval or disapproval of the previous design.

17. Mr. Quance occasionally furnished sketches to Foster Wheeler to illustrate how he thought the refinery should be designed. He was especially instrumental in changing Foster Wheeler's proposed plot plan to make the refinery more compact, in order to save piping and construction funds, and was also actively involved in designing the piping system to be used in the refinery.

18. (a) In early 1971, Foster Wheeler submitted to HIRI, for its approval, a design for the refinery together with a definitive estimate of cost. While HIRI accepted most of the engineering information, it rejected the estimate, which was considerably higher than what it had budgeted for the refinery. Projected cost overruns on the two offsite components further aggravated the situation.

(b) Mr. Quance was thereupon instructed to devise ways in which to reduce the cost of Foster Wheeler's proposed plan by approximately 5 to 10 percent, or from one to two million dollars. Foster Wheeler also prepared proposed reductions. As part of the reduction-in-scope program, Mr. Quance effected, *inter alia*, the redesign of the sour water stripper; the relocation of the flare stack; the elimination of a number of valves, pumps and a caustic wash system; a standardization of the tank farm pumps; a reduction in piping and in the size of steam generators and boilers; the redesign and rearrangement of the Merox (desulfurization) units; and the

removal of construction of the refinery building from the scope of Foster Wheeler's work. As a result of Mr. Quance's discussions with Foster Wheeler, it also came up with ways of saving money, the principal one being the elimination of a structure for the crude overhead exchanger. Approximately 5 to 10 percent (in dollar value) of the original Foster Wheeler design was so modified.

(c) The reduction-in-scope changes were ultimately reduced to writing and incorporated in the Foster Wheeler proposal as an "Addendum to Scope of Work," dated June 17, 1971, consisting of 23 scope changes.

19. (a) In June 1971, HIRI and Foster Wheeler executed a fixed sum definitive contract, stated to be effective as of May 12, 1970. Therein the parties agreed that in return for a lump sum price of $21,324,000:

> Foster Wheeler shall diligently perform and execute the following work, * * * for the grass-roots refinery to be located within the refinery fence at Barber's Point, Oahu, Hawaii and, to the extent applicable, for the associated tank-truck loading station and for the car-parking area in front of the administration building:
>
> Perform process engineering;
>
> Prepare all drawings, specifications and requisitions;
>
> Procure all materials and subcontract services; said materials and services to be procured as agent of HIRI except when procured in the field;
>
> Inspect, expedite, arrange for shipment and delivery of all materials to the Work site;
>
> Unload all materials at the Work site;
>
> Furnish supervision, labor and construction tools and equipment; and
>
> Construct and erect said refinery, tank-truck loading-station and parking area.

The contract further provided that Foster Wheeler was required to perform the work in accordance with nine exhibits and an appendix of five volumes of technical specifications.

(b) The lump sum price was to be paid by HIRI to Foster Wheeler in progress payments over a fixed time schedule. The price was subject to adjustment for, *inter alia*, "the change in the Cost of the Work in the event HIRI specifies the purchase of materials or services from suppliers, vendors or subcontractors, other than those

selected by Foster Wheeler from a vendors' list previously approved by HIRI," and "for alterations in, additions to, or deletions from the Work requested by HIRI." In this latter regard, the contract expressly stated that "HIRI shall have the right, at any time and from time to time prior to mechanical acceptance of the Work to request in writing, alterations in, additions to and deletions from the Work," and that once the amount of the cost adjustment was agreed to, "Foster Wheeler shall proceed with the Change."

(c) The contract also provided that HIRI was responsible for the following:

VIII. *Services and Materials by HIRI*

HIRI shall provide the following at HIRI's expense in connection with the Work, in addition to items specified as "O" in Exhibit III and items listed in Exhibit IV.

A. The Work site cleared of vegetation, free of obstruction above and below grade level, rough-graded to elevation approximating finished grade and fenced.

B. All reference points established and set in place, which Foster Wheeler shall use in setting its lines and levels.

C. At such times as required by Foster Wheeler, services in Foster Wheeler's office of an engineer authorized by HIRI to approve designs and drawings.

D. All permits, licenses, and similar documents required to be in HIRI's name in connection with the Work and the operation of the Plant.

E. Information as to the type of foundations to be used. In the case of piled foundations, HIRI shall advise Foster Wheeler as to the type and length of pile to be used and the design bearing load per pile. In the case of spread foundations, HIRI shall advice Foster Wheeler of safe soil loading values to be used in the design and the depth at which said values will be encountered. If HIRI cannot supply Foster Wheeler with said foundation information, Foster Wheeler shall recommend to HIRI a qualified consultant who shall make sub-surface investigations and who shall develop the design basis for foundations. Foster Wheeler assumes no responsibility for the recommendations of the consultant or for HIRI's information; Foster Wheeler's responsibility shall be limited to the execution of the foundation designs and installation of the foundations in a

workmanlike manner using the design basis provided by HIRI or by the consultant.

F. Clear space suitable for parking construction workers' cars within 500 feet of the Work site.

G. The following utilities furnished at Refinery Fence as required for construction purposes:

Electricity: 200 v, 3-phase, 60 cycles
Water: Test and potable

H. All tools, record sheets, log tables, laboratory and testing facilities, instrument charts, spare parts, catalysts, chemicals, solvents, and any other consumable supplies for maintenance and operation, including acceptance testing, of the Plant.

I. All labor, including standby labor during start-up, materials and utilities for maintenance and operation of the Plant from the date of Mechanical Acceptance.

J. Mobile equipment and maintenance equipment for maintenance and operation of the Plant.

(d) The agreement further recited that "All materials * * * shall become the property of HIRI, f.o.b. vendors' plant[s]"; and that "HIRI shall at all times bear the risk of damage to, or loss of * * * all materials, equipment, tools, supplies and other items furnished by Foster Wheeler or by others * * * from the time the foregoing are placed in transit," and of "all work completed or in progress, resulting from any cause whatsoever." HIRI was also required to "provide All-Risk Binders Risk Insurance covering such items" and "Ocean Marine Cargo insurance on materials and supplies intended for incorporation into the work until such materials and supplies are delivered to the work site."

(e) HIRI retained the right "at any time [to] stop the Work on any part thereof for less than 30 days" and to require its resumption on 10 days notice subject to payment of Foster Wheeler's expenses resulting from the suspension. It also reserved the right to terminate the work entirely subject to the obligation to reimburse Foster Wheeler's for its costs plus 2½ percent of such cost. In the event of such termination, Foster Wheeler was to vest in HIRI its rights under agreements with vendors and others and to deliver to HIRI all drawings, data and other material prepared by Foster Wheeler in performance of the work to date of termination.

20. After the contract was executed, Foster Wheeler draftsmen

prepared additional drawings, called working or construction drawings, which were to be used by the construction workmen in the field. Certain of the vendors also furnished so-called "shop" or "spool" drawings for the equipment they supplied. These construction and shop drawings were prepared using the specifications which had been appended to the contract. Mr. Beebe and Mr. Quance also checked the construction drawings, often offering comments, suggestions and recommendations regarding them.

21. Pursuant to the "Changes" clause in the Foster Wheeler agreement, 15 modifications to the contract plans and specification were made, most of them at HIRI's request. Various other modifications were made at HIRI's behest which did not involve cost adjustments, and therefore, did not necessitate recourse to the formal contract changes procedure. To ensure that the estimated cost of the project would not appreciably exceed the contracted amount, HIRI's lenders required HIRI's principal construction contractors to limit contract changes to increases of no more than 2 percent of the agreed-upon price.

22. It is not feasible to trace and identify all of those portions of the final designs, drawings, plans and specifications that were attributable to HIRI's ideas, proposals, suggestions, recommendations, or instructions. It is clear, however, that to a significant extent HIRI's employees influenced and affected the content and make up of the contract plans and specifications, and that the facility that was actually constructed was superior to and at a lower cost than that which would have been built had HIRI provided no input.

23. (a) Foster Wheeler subcontracted almost all of the construction work. Under the terms of the contract with HIRI, Foster Wheeler was permitted to subcontract out the work on the condition that it would not be relieved of any of its obligations and responsibilities under the contract. The bulk of the work was carried out by approximately 15 subcontractors. Most of the work involved the assembly and installation of equipment.

(b) Foster Wheeler also acted as the construction supervisor for the refinery. Its construction personnel dealt with the subcontractors' supervisors, who, in turn, gave orders to the workmen on the jobsite. Foster Wheeler sent a crew of 10 to 15 supervisors to coordinate, inspect and supervise the construction. These supervisors were at the worksite continuously.

24. (a) All building permits and licenses to construct the oil

refinery were secured by HIRI and issued in its name. In addition, it also obtained all necessary state, Coast Guard, and Corps of Engineers permits to build the offsite components.

(b) Physical construction (other than site clearing) of the refinery began in January, 1971. The refinery was placed in service in June 1972, but was not totally completed until 1973. Physical construction on the offsite components commenced sometime after April 1, 1971. The cost to HIRI of the entire facility totalled $31,800,587.

25. During the construction, Messrs. Beebe and Quance visited the worksite several times per week. Their inspection was focused on workmanship. In the course of these inspections, they also checked the equipment and apparatus to verify that it was being installed and erected in accordance with the contract plans and specifications. HIRI's operating and maintenance staff, some of whom were hired as early as October 1971, were also at the worksite to familiarize themselves with the equipment, and to train and prepare for start-up.

26. As part of the reduction-in-scope program, HIRI decided to arrange for the construction of the refinery's administration building itself. Mr. Quance prepared a basic sketch of the desired floor plan and HIRI let out the construction work to a contractor. After completion of the building in early 1972, several months before finishing of the refinery, some of HIRI's personnel moved into the building and thereafter were present at the worksite on a full-time basis.

27. (a) Foster Wheeler gave notice to HIRI of mechanical completion of the refinery on April 8, 1972. The construction contract for the refinery provided that, upon mechanical completion of the work, but prior to mechanical acceptance by HIRI, Foster Wheeler would give written notice to HIRI whereupon the latter would have ten days to notify the former of any item requiring additional work. Pursuant to this provision, HIRI submitted a "punch list" of approximately 50 items which had to be repaired before it would accept the work.

(b) Prior to mechanical completion of the refinery the equipment was inoperable due to safety considerations and because the system was not energized. At this time, HIRI's personnel were restricted to visual inspection and familiarization.

(c) The start-up of the facility was handled exclusively by HIRI. A disagreement between HIRI's personnel and Foster Wheeler's staff as to the best way to conduct the start-up was resolved in favor of HIRI. The first crude oil arrived in April 1972, and the refinery became operational two months later.

28. (a) In regard to the marine terminal HIRI's original arrangement with Bechtel was that HIRI would outline generally its planned method of operations and Bechtel would design something suitable to carry it out. But since HIRI had not decided finally how many pipelines it needed, the size of the ships it wanted to accommodate at the mooring point, the length of the underwater pipeline, the number of terminals, whether or not it would also convey finished products to barges in the harbor for transportation elsewhere, and other alternatives, it had Bechtel draw up many designs.

(b) HIRI exercised final authority over design decisions, including the decision to use a multi-point, rather than a single point, mooring system. HIRI also retained an outside consultant to assist in the selection of the type of moorings and equipment, and to review Bechtel's plan and designs.

(c) HIRI's agreement with Bechtel expressly provided that "HIRI shall have free access to and the right to inspect any part of the Project at any time, including all drawings, plans, cost estimates, schedules and other documents prepared by Bechtel for the Project." Mr. Bean, the project engineer for the offshore mooring, and certain of the HIRI's operating staff reviewed the proposed plans and specifications to determine if the designs would be workable.

29. Bechtel's initial plan for the marine terminal contemplated a single pipeline running from the offshore mooring site to the refinery. When Messrs. Bean, Beebe and Quance became concerned with the possibility that, because of the thickness of some of the crude oil HIRI contemplated buying, this single line could clog, a more sophisticated four-line pipe system was devised.

30. (a) HIRI entered into two service contracts with Bechtel, the first effective August 12, 1970, the second March 31, 1971. The first agreement called for Bechtel to procure the necessary materials and perform engineering services for the design of the marine terminal. The agreement provided that "Construction of the project will be supervised and inspected [by Bechtel] to assure that the installation is in accordance with the plans and specifications, is of the quality desired, and that all components satisfactorily pass specified tests." All inspection was performed by Bechtel, which then reported to Mr. Bean.

(b) The initial Bechtel contract also provided that Bechtel would distribute copies of the construction contract documents to prospective bidders, evaluate the bids, and make a recommendation

to HIRI for a construction contractor. Pursuant to this provision, HIRI selected Healy Tibbits to serve as the construction contractor for the marine terminal, and a formal agreement between these two parties was executed on May 21, 1971. The contract provided that Healy Tibbits "shall be responsible for executing the WORK in accordance with the Specification[s];" that "[n]o deviations from the Specifications shall be allowed;" and that "[a]ll detailed drawings prepared by the CONTRACTOR shall be submitted for OWNER'S approval before orders for materials are placed."

(c) The second agreement between HIRI and Bechtel stated that "subject to the general direction and control of HIRI," Bechtel would perform a range of services comprised of:

1. Planning, Scheduling, Estimating and Cost Control;
2. Procurement Services;
3. Construction Management Services;
4. Commissioning, Startup and Initial Operation Services;
5. Administration Services.

The contract also directed that Bechtel should "consult with HIRI in advance of important decisions and commitments relating to the Project." In the performance of these services, Bechtel was to be "the authorized representative or agent of HIRI."

31. The first crude oil flowed through the mooring and the terminal into the plant in April 1972.

32. HIRI also set up the design criteria for the products pipelines, determined their routes, capacities and terminals, and made provisions in the plan for eventual expansion of the system. The task of obtaining the many easements and rights of way needed for the pipeline routing was handled for HIRI by Mr. Bean.

33. (a) By contract, having an effective date of May 1, 1971, HIRI retained Resource Sciences Corporation, the parent corporation of Williams Brothers Engineering, to design, engineer, prepare complete specification, and procure materials for the products pipeline. The contract provided that "[HIRI] hereby constitutes and appoints [Williams Bros.] as its agent and manager of engineering and construction to perform, or cause to be performed, the engineering, design and material procurement; to manage and inspect the construction to completion and testing the pipeline system; * * * and to act generally for [HIRI] and in all matters duly assigned in connection therewith." Williams Bros. agreed to "[p]erform construction inspection to the end that all construction will be in accordance with the

specifications, drawings, contract, code and other requirements." HIRI retained final authority to approve the design of the products pipeline. By agreement dated November 30, 1971, HIRI contracted with Hood for the construction of the products pipeline.

(b) The construction contracts for the marine terminal and products pipelines contemplated that HIRI would furnish most of the materials needed for construction (including the pipe) that HIRI would retain title thereto, and that HIRI would either obtain the appropriate insurance or assume the risk of loss thereof. Major items of materials, such as the pipe, were purchased by HIRI before the construction contracts were let.

34. (a) HIRI timely filed its federal corporation income tax returns for calendar years 1972, 1973 and 1974, using the accrual method of accounting. On its federal income tax returns HIRI claimed an investment tax credit of $2,226,041 based on its cost for the entire facility.

(b) The Internal Revenue Service on audit disallowed partially investment tax credits claimed with respect to the property in issue, in the amount of $963,749, based upon an IRS determination that the facility was constructed by HIRI during the period that the investment credit was terminated under Sections 49 and 50 of the Internal Revenue Code of 1954.

(c) On or about October 23, 1978, the Internal Revenue Service, with respect to the taxpayer's 1974 federal income taxes, assessed additional taxes of $572,772, attributable entirely to the disallowed investment credits described above usable in 1974. Taxpayer paid the assessed deficiency plus interest, and filed timely claims for the refund of those amounts. The claim for refund was denied by the Internal Revenue Service and taxpayer timely filed suit in this court.

CONCLUSION OF LAW

Based upon the foregoing findings of fact and opinion, it is concluded that the petition should be dismissed and judgment entered for defendant.

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

HAWAIIAN INDEPENDENT REFINERY INC., Appellant,	)	
v.	)	No. 240-79T
THE UNITED STATES, Appellee.	)	

ORDER

A suggestion for rehearing en banc and a petition for reconsideration having been filed in this case,

UPON CONSIDERATION THEREOF, it is Ordered by the court that the suggestion for rehearing en banc and the petition be, and the same are hereby, Denied.

FOR THE COURT:
/s/ George E. Hutchinson

Clerk

February 23, 1983
Date

APPENDIX D

Applicable Statutes and Regulations

Sec. 38 Investment in Certain Depreciable Property.

(a) General Rule.—There shall be allowed, as a credit against the tax imposed by this chapter, the amount determined under subpart B of this part.

(b) Regulations.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section and subpart B.

Reg. § 1.38-1 Investment in Certain Depreciable Property. Sections 1.46-1 through 1.48-7, inclusive, are prescribed under the authority granted the Secretary or his delegate by section 38(b) of the Code to prescribe such regulations as may be necessary to carry out the purposes of section 38 and subpart B, part IV, subchapter A, chapter 1 of the Code.

Sec. 46 Amount of Credit.

(a) Determination of Amount.—

(1) General Rule.—The amount of the credit allowed by section 38 for the taxable year shall be equal to 7 percent of the qualified investment (as defined in subsection (c)).

Sec. 48. Definitions; Special Rules.

(a) Section 38 Property.—

(1) In General.—Except as provided in this subsection, the term "section 38 property" means—

(A) tangible personal property, or

(B) other tangible property (not including a building and its structural components) but only if such property—

(i) is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

(b) New Section 38 Property.—For purposes of this subpart, the term "new section 38 property" means section 38 property—

(1) the construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1961, or

(2) acquired after December 31, 1961, if the original use of such property commences with the taxpayer and commences after such date.

In applying section 46(c)(1)(A) in the case of property described in paragraph (1), there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection after December 31, 1961.

(h) Suspension of Investment Credit.—For purposes of this subpart—

(1) General Rule.—Section 38 property which is suspension period property shall not be treated as new or used section 38 property.

(2) Suspension period property defined.—Except as otherwise provided in this subsection and subsection (i), the term "suspension period property" means section 38 property—

(h) Suspension of Investment Credit.—

(2) Suspension period property defined.—

(A) the physical construction, reconstruction, or erection of which (i) is begun during the suspension period, or (ii) is begun, pursuant to an order placed during such period, before May 24, 1967, or

(B) which (i) is acquired by the taxpayer during the suspension period, or (ii) is acquired by the taxpayer, pursuant to an order placed during such period, before May 24, 1967.

In applying subparagraph (A) to any section 38 property, there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection before May 24, 1967.

Reg. § 1.48-2 New Section 38 Property. (a) In general. Section 48 (b) defines "new section 38 property" as section 38 property—

(1) The construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1961, or

(2) Which is acquired by the taxpayer after December 31, 1961, provided that the original use of such property commences with the taxpayer and commences after such date.

In the case of construction, reconstruction, or erection of such property commenced before January 1, 1962, and completed after December 31, 1961, there shall be taken into account as the basis of new section 38 property in determining qualified investment only that portion of the basis which is properly attributable to construction,

reconstruction, or erection after December 31, 1961. See § 1.48-1 for the definition of section 38 property.

(b) Special rules for determining date of acquisition, original use, and basis attributable to construction, reconstruction, or erection. For purposes of paragraph (a) of this section, the principles set forth in paragraph (a)(1) and (2) of § 1.167(c)-1 shall be applied. Thus, for example, the following rules are applicable:

(1) Property is considered as constructed, reconstructed, or erected by the taxpayer if the work is done for him in accordance with his specifications.

(2) The portion of the basis of property attributable to construction, reconstruction, or erection after December 31, 1961, consists of all costs of construction, reconstruction, or erection allocable to the period after December 31, 1961, including the cost or other basis of materials entering into such work (but not including, in the case of reconstruction of property, the adjusted basis of the reconstructed property as of the time such reconstruction is commenced).

(3) It is not necessary that materials entering into construction, reconstruction, or erection be acquired after December 31, 1961, or that they be new in use.

(4) If construction or erection by the taxpayer began after December 31, 1961, the entire cost or other basis of such construction or erection may be taken into account as the basis of new section 38 property.

(5) Construction, reconstruction, or erection by the taxpayer begins when physical work is started on such construction, reconstruction, or erection.

(6) Property shall be deemed to be acquired when reduced to physical possession, or control.

(7) The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. For example, a reconditioned or rebuilt machine acquired by the taxpayer will not be treated as being put to original use by the taxpayer. The question of whether property is reconditioned or rebuilt property is a question of fact. Property will not be treated as reconditioned or rebuilt merely because it contains some used parts.

If the cost of reconstruction may properly either be capitalized and recovered through depreciation or charged against the depreciation reserve, such cost may be taken into account as the basis of new

section 38 property even though it is charged against the depreciation reserve.

(c) Examples. This section may be illustrated by the following examples:

Example (3). In 1961, a taxpayer pays the entire purchase price of $10,000 for section 38 property to be delivered in 1962. In 1962 he takes possession of the property and commences the original use of the asset in that year. The $10,000 amount shall be taken into account in computing qualified investment in new section 38 property for 1962.

Sec. 49 Termination of Credit.

(a) General Rule.—For purposes of this subpart, the term "section 38 property" does not include property—

(1) the physical construction, reconstruction, or erection of which is begun after April 18, 1969, or

(2) which is acquired by taxpayer after April 18, 1969, other than pre-termination property.

This subsection shall not apply to property described in section 50.

Sec. 50 Restoration of Credit.

(a) General Rule.—Section 49(a) (relating to termination of credit) shall not apply to property—

(1) the construction, reconstruction, or erection of which—

(A) is completed by the taxpayer after August 15, 1971, or

(B) is begun by the taxpayer after March 31, 1971, or

(2) which is acquired by the taxpayer—

(A) after August 15, 1971, or

(B) after March 31, 1971, and before August 16, 1971, pursuant to an order which the taxpayer establishes was placed after March 31, 1971.

(b) Transitional Rule.—In applying section 46(c)(1)(A) in the case of property described in subsection (a)(1)(A) the construction, reconstruction, or erection of which is begun before April 1, 1971, there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection after August 15, 1971. This subsection shall not apply to pre-termination property (within the meaning of section 49(b)).

Reg. § 1.50-1 Restoration of Credit. (a) In general. Section 49(a) (relating to termination of credit) does not apply to property—

(1) The construction, reconstruction, or erection of which by the taxpayer—

(i) Is completed after August 15, 1971, or

(ii) Is begun after March 31, 1971, or

(2) Which is acquired by the taxpayer—

(i) After August 15, 1971, or

(ii) After March 31, 1971, and before August 16, 1971, pursuant to an order which the taxpayer establishes was placed after March 31, 1971.

(b) Transitional rule. In the case of property (other than pretermination property) the construction, reconstruction, or erection of which by the taxpayer is begun before April 1, 1971, and completed after August 15, 1971, there shall be taken into account as the basis of new section 38 property in determining qualified investment only that portion of the basis which is properly attributable to construction, reconstruction, or erection after August 15, 1971.

(c) Principles to be applied. The principles of § 1.48-2(b) and (c) shall be applied in determining when property is acquired and in determining that portion of the basis of property properly attributable to construction, reconstruction, or erection after August 15, 1971.